A BILL PUBLICATION FAST FOOD

Restaurant Business

JULY 20, 1984

New Orleans close-up
page 111

Hilton International
Explores New Vistas
page 151

Legal Sea Foods page 98
Poultry page 189
LATELINE page 221

Restaurant Business

July 20, 1984 VOL. 83 NO. 11

Contents

COVER STORY

Hilton International Explores New Vistas
With a strong emphasis on its foodservice operations, this hotel chain has created a cornucopia of creative cuisines that showcase local specialties throughout 90 properties in 45 countries. Total food and beverage sales contributed over 44 percent ($480 million) to total company revenues 151

MENU IDEAS

A poultry primer
This month, in the *Restaurant Business* Test Kitchen, food editor Kathleen Sanderson demonstrates the versatility of poultry by preparing a variety of dishes using five cooking methods 189

FEATURES

Legal Sea Foods
An extensive menu and unusual service approach have made five family-owned seafood restaurants landmarks in the Boston area 98

A taste of New Orleans
A look at the rich culinary heritage of the "Crescent City" and many of the restaurants popular today 111

Tax credit
Free training and lower taxes are possible through the Job Training Partnership Act (JTPA) 138

Seafood Survey
The results of a recent consumer study conducted by the North Atlantic Seafood Association can be helpful in menu planning 144

DEPARTMENTS

Training Tips 2

RB Insights 12

RB Spotlight: Buffalo 14

Editorial
A new era for hotel dining 20

Publisher's Memo 24

Up Front 28

Menu Planners Guide 52

Calendar 68

Tax Bite
A wonderful new tax animal 74

Executive Profile
John Metz, Custom Mgmt 80

Personal Finance
The world of mutual funds 88

Book Review 93

Restaurant Stirrings 95

Drafts, Carafes & Spirits
Handle with care 169

Bar Management Guide 174

Wine Seller
The profit potential of wine 178

Raising Your Equipment I.Q.
Fryers and filters 182

Design Marketplace 197

Buyer's Circle 198

Sanitation 212

Classifieds 216

Trade Quotes 220

RB Lateline 221

RB Eyes Washington 224

Restaurant Openings 226

Cover photo, by Charles Wiesehahn, was shot at the American Harvest restaurant, Vista Hotel, New York City. Left to right are: Roger Davis, Eddy Florijn, Walter Plender, Charles Bell, Alain Roby, and Fred Rufe.

A wonderful new tax animal

by Irving L. Blackman

Imagine a wonderful new tax animal that brings financial good will everywhere it goes. Not only that, it divides into clones that continue the cheer-spreading tax word. Sheer fantasy, right? It couldn't happen in the real, tough tax world of the good ol' USA, right? Well, it has. Such a tax animal exists, right now! And its numbers are growing. At this writing, there are only hundreds of them. But soon, there will be thousands. Most people call them "*Section 401(k) plans.*"

These plans are more than a tax scheme. They allow every employer in the country to give every employee an opportunity to invest in a legitimate tax shelter. A tax fantasy truly has become reality.

In a nutshell, a 401 (k) plan allows employees to defer a portion of their salary into a company-qualified profit sharing plan, where it accumulates tax-free until withdrawn. An employee receives an immediate income tax savings equal to the amount contributed to the plan multiplied by his or her highest tax bracket. For example, Joe Smart earns $25,000 per year at Speedy Co., which has established a 401 (k) plan. Under the plan, employees can contribute up to 10 percent of compensation. Joe, who is in a 30 percent bracket, contributes $2,500 to the plan. Joe's taxable earnings from Speedy for the year are $22,500 ($25,000 minus $2,500). His income tax savings is $750 ($2,500 x 30 percent).

Participation in the plan is voluntary. One employee might elect to contribute 10 percent of compensation (like Joe), another five percent, and another zero. The law divides the employees into two groups: The highest paid one-third of the employees make up the "Higher-paid Group" and the other employees make up the "Lower-paid Group." A series of rules determine the amount that the Higher-paid Group can contribute to the plan, depending on how much the Lower-paid Group elects to contribute.

> Make a tax fantasy reality. Give employees a chance to invest in a legitimate tax shelter.

The out-of-pocket cost for plan contributions can be zero to the employer. It is the employee who directs a portion of his salary to the plan. True, the employer makes the payment to the plan on the employee's behalf. But it is the employee's money, which the employer would have paid to the employee if not for the direction to pay the plan instead.

There are a number of advantages to the employee: 1. The limit per individual employee is $30,000 (and a $2,000 contribution to an IRA also can be made). 2. All amounts contributed by the employee, plus all earnings accumulated are irrevocably vested in the employee at all times. 3. A number of investment choices, which can be changed periodically, are available to each employee. 4. The employee can borrow from the plan prior to withdrawal (withdrawal is permitted only for retirement, death, separation from service, hardship, or the employee's attaining age 59½. 5. When the funds are withdrawn, the employee is entitled to a substantial tax break called "Special 10-year averaging," which slashes the amount of tax due.

The author, an attorney and a certified public accountant, is senior partner at Blackman, Kallick and Co., Chicago and author of "Winning the Tax Game."

Chances of IRS audit

The IRS audit game goes on. If you're lucky, you will not be invited to play. What are your chances?

Here's an overview: The IRS audited 1,427,660 individual income tax returns in fiscal 1983 out of the 95.4 million filed for 1982. That's an average of 1.49 percent compared to 1.55 percent for the year before. Whether your return will be subjected to an agent's scrutiny depends on many factors, including how well you get along with Lady Luck. One thing is certain: the higher your income, the better your chances. The IRS has released the breakdown on individual non-business tax returns subjected to examination.

What are the chances of your business being audited? The schedule below shows the chances of a business return to have been audited

continued on page 76

Individuals—(Income without considering loss) *Percent of Returns Examined*	
$10,000 under $25,000 (with itemized deductions)	215
$10,000 under $25,000 (without itemized deductions)	64
$25,000 under $50,000	261
$50,000 and over	493

Non-Corporate Businesses (Based on Income) *Percent of Returns Examined*	
Under $25,000	1.63
$25,000 under $100,000	3.28
$100,000 and over	6.12

Corporation (Based on Assets)	
Under $100,000	1.96
$100,000 under $1 Million	3.45
$1 M under $10 M	9.90
$10 M under $100 M	22.47
$100 M and over	57.83

continued from page 74

in 1983. For example, if your corporation had between $1,000,000 and $10,000,000 in assets, you were just about a one-in-ten shot for hosting an examining agent during 1983.

Estate taxes

Can estate taxes really be eliminated? The answer to this intriguing question is YES—if you know how. Let's take a look at a real case where a tax hero tried but failed. Tetsuo Kurihara (let's call him TK) created an irrevocable (simply means, cannot be changed) trust. On the same day, the trustee applied for $1,000,000 of insurance on TK's life, mentioning a specific policy number. After about a month the policy was issued and TK wrote a check, which had the policy number noted on it, payable to the trustee for the exact amount of the premium. The trustee paid the premium by endorsing the check to the insurance company.

Two months later, TK went to heaven (all tax heroes go to heaven) after being killed in an auto accident. The IRS included the $1,000,000 in TK's estate claiming TK had purchased the policy (not the trusteee) and transferred it to the trust. Under the tax law, such a transfer requires TK to survive for three years in order to keep the $1,000,000 policy proceeds out of his estate. If the trustee had purchased the policy, the $1,000,000 would not be taxable in his estate. The IRS won (Kurihara Estate 82 TC 4-1984).

This is a sad case that at best can be classified as, "Nice try." The most unfortunate part of the story is that what TK failed to do, can easily be accomplished if properly done. Not only can an irrevocable trust be used to avoid estate tax on the life insurance proceeds of the insured (like TK), it can be used a second time to avoid tax on the proceeds at the death of the insured's spouse (like TK's wife).

This estate planning technique is being used often to pass estates on to the surviving family without burdening the estate with any outlay for estate taxes. In a nutshell, here's the estate-tax-free-game plan: 1. Create an irrevocable trust to purchase life insurance equal to the amount of your estimated tax liability; 2. No tax is due no matter which spouse dies first; the trust collects and keeps 100 percent of the proceeds; 3. The proceeds are loaned to the executor to pay the estate taxes due; and 4. The executor pays the loan back to the trust after it liquidates enough estate assets. Ultimately, the trust assets are distributed to the surviving children and grandchildren.

Warning: This article does not attempt to cover all of the details, rules and exceptions. Hire a competent professional.

Nice guys do win

If you make payments when you had no legal obligation to do so, the amount paid is not deductible. And the rule makes sense. Simply put, your payments were voluntary, a gift, and gifts are not deductible.

Conway Twitty, the well-known country music singer, beat the rule and the IRS. Here's the delightful tax story. A number of Conway's friends invested in Twitty Burger, Inc., which was a burger franchise corporation. Ultimately the franchise operation went belly-up. Conway's unhappy investor friends were made happy when he fully compensated them for the loss.

Conway deducted the payments. The IRS denied them saying there was no business purpose and that the payments were made out of a sense of moral obligation. Conway claimed the payments were deductible in his business of being a country music performer. For what reason? He paid the investors to protect his personal business reputation. In his business this is essential because country music fans are acutely sensitive to any moral flaw perceived in such entertainers.

The tax court (*Harold L. Jenkins, TC Memo 1983-67*) chewed up the IRS' arguments and allowed Conway a full deduction. See, nice guys do win.

A BILL PUBLICATION FAST FOOD®

AUGUST 10, 1984

MERGERS ACQUISITIONS

page 147

Market segment report: Barbecue page 108

Festival Cafe page 98

Ethnic Entrees page 197

LATELINE page 237

Restaurant Business

August 10, 1984 VOL. 83 NO. 12

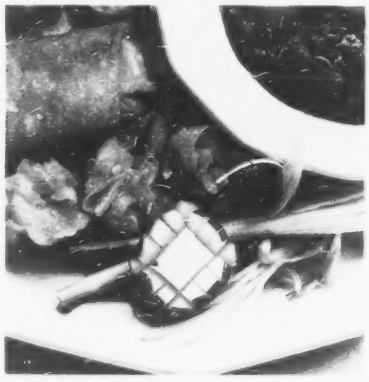
Contents

COVER STORY Mergers & Acquisitions

In this exclusive cover story, the editors of *Restaurant Business* have compiled a select listing of foodservice concerns involved in major mergers and acquisitions since 1979. In addition, we profile four prominent players: Saga, Diversifoods, Vicorp and R. J. Reynolds. Read about how and why these mergers and acquisitions occurred and find out who owns whom 147

MENU IDEAS

Ethnic entrees
If you want to add a foreign flair to your menu, food editor Kathleen Sanderson shows how simple it can be to create variety of international entrees 197



FEATURES

Rockefeller Center
A new complex of restaurants which celebrate American cuisine, and were developed by Restaurant Associates, give the Rockefeller Center promenade a different, modern look 98

Market segment report: Barbecue
Restaurant Business continues its exclusive series with a look at the growth concepts in the barbecue segment 108

Spiaggia
An elegant atmosphere, a Magnificent Mile location, and Northern Italian cuisine combine to form the Levy Organization's newest upscale concept in Chicago. The restaurant serves as a springboard for growth ... 134

Public Offerings
Dozens of restaurant companies are raising millions of dollars to finance growth 176

DEPARTMENTS

Sanitation Tips 2

RB Insights 12

RGI Spotlight: Oklahoma City .. 14

Editorial
Serving the 'Boutique Generation' 20

Publisher's Memo
Merger Mania 24

Up Front 28

Menu Planners Guide 60

Tax Bite
A tip for closely held businesses . 76

Personal Finance
The year of the 'megamerger' ... 84

Restaurant Stirrings 92

Trade Quotes 94

Drafts, Carafes & Spirits
Wines by the glass 183

Bar Management Guide 188

Raising Your Equipment I.Q.
Conveyorized broilers 190

Chef's Art
Michael McCarty, Michael's ... 205

Buyer's Circle
The latest in equipment 208

Management Psychology 220

Training
Big Boy boasts 'family feeling' . 222

Executive Profile
Jim Furry, Grand American Fare 224

Operations Savvy
Public speaking 228

Classifieds 232

Calendar 236

Lateline 237

RB Eyes Washington 240

Restaurant Openings 242

Cover design by Joan Dworkin

Market Segment Report

Enticing platter shows various items offered by Florida-based Fat Boy's Bar-B-Q.

Barbecue: The accent is on regional growth

by Jacque Kochak

Barbecue tastes are as regional as accents.

In Nashville, barbecue is "pulled and dry," flavored with dry spices instead of sauce, then pulled from the bone in long, stringy pieces.

In Memphis, natives like barbecue "chopped and wet," rich with sauce.

Some areas swear by pork, while points west of the Mississippi, especially Texas, say barbecue had better be beef—preferably brisket. If Texans eat pork, they like spareribs. Floridians eat beef barbecue, too, but theirs is top or bottom round. Their pork barbecue is usually back ribs.

Northerners, devoid of their own tradition, are likely to embrace any style that comes along, and some Yankees think that spareribs cooked in the oven with store-bought sauce for an hour are "barbecued."

Whatever the taste preference, barbecue is riding a new wave of popularity. Today, the "barbecue" segment breaks out into three parts. There are the traditional barbecue restaurants, stereotyped as roadhouses on Southern back highways; there are their upscale California cousins; and there are the rib houses. The rib houses first began expanding several years ago and have proven to have staying power. Now the mid-price barbecue houses are expanding and upgrading.

The very regionality of barbecue tastes has been a factor in slowing expansion of the traditional barbecue houses. "We have looked at barbecue as a possibility for our company, but the regionalism discouraged us," admits Dave McKenzie, a spokesman for Southern Hospitality, which operates a variety of concepts in the South.

Nevertheless, the popularity of Southern barbecue is an irresistable lure to profit-minded businessmen. Barbecue is so popular that the Hickory Log in Dexter, Missouri, lets helicopters land in the back so executives can ferry ribs back home to Memphis, and folks start lining up by 3 a.m. at Whitt's Barbecue in Athens, Alabama, on July 4th.

Barbecue restaurants are now proliferating in New York City, and in San Francisco Hog Heaven is teaching devotees of California cuisine about Memphis barbecued pork shoulder. Diversifoods is plotting rapid expansion of its Luther's chain, Clorox has acquired Emil Villa's Original Hick'ry Pit, and Far West Services, a subsidiary of giant W.R. Grace, last year acquired a small California-based company, Mor Food 'n Fun, and is expanding its popular R.J.'s the Rib Joint. Several low-profile regional chains are preparing for eventual national expansion, and other smaller chains like Georgia's Hickory Houses and Kansas City's Gates & Sons flourish.

Nevertheless, barbecue is still a rarity in some parts of the country. There are only 5,203 barbecue restaurants in the entire U.S., a mere 1.8 percent of total restaurants, according to the most recent RECOUNT study. Of those, more than a third (1,874 restaurants, or 4.7 percent of total restaurants in the country) are located in the West/South Central region. Almost one fourth (1,071 restaurants, or 2.5 percent of total restaurants) are located in the

continued on page 110

Barbecue *continued from page 108*

South Atlantic region.

"I feel like we're about where Mexican food was three years ago," says Jay Bradley, executive vice president of Florida-based Fat Boy's Bar-B-Q.

That optimism is echoed by operators around the country. All agree that barbecue is popular, though the degree of "trendiness" varies from city to city. In the South, barbecue is king; the only debate is which variety is best. In New York City, rib restaurants are opening everywhere, but in Chicago, executives are rather ho-hum about the subject. Barbecued ribs have a loyal following there, but they're not as "fashionable" as in New York. On the West Coast, a few barbecue and rib restaurants have carved out niches for themselves, but they consider themselves outposts.

Paul Rimmeir, owner of Rib-It, a five unit Philadelphia-based chain poised for growth.

Barbecue restaurants

The moderately priced, family-oriented traditional barbecue segment is dominated by independents, but Diversifoods' Luther's is establishing a strong presence. Luther's was a small Houston chain when ac-

continued on page 114

BARBECUE GROWTH CONCEPTS

Name	1983 Sales	No. of Units (as of mid-1984)	Avg. Unit Volume	Outlook
Luther's	$67 million*	56	$1.3 million	Plans to open 90 units in 1984, most in the second half of the year. Could have 255 units by end of '85.
Tony Roma's	$60 million	37	$2 million	Plans to open approximately 24 units in '84, but is keeping quiet about locations.
Sonny's Bar-B-Q	$58 million	58	$950,000	Planning to expand outside Florida base, mainly in the Southeast.
Fat Boy's Bar-B-Q	$22.5 million	49	$600,000	Expects to open 25 new units next year, all franchised. Much of growth will be a new fast-food prototype.
Bobby Rubino's	$47 million*	24	$2 million	Projects 20 to 25 units in the next three years. Franchising will account for 70 percent of growth.
Emil Villas' Original Hick'ry Pit	$15 million	11	$1.6 million	Recently acquired by Clorox. Expansion plans on hold while concept is refined.
Carson's	$15 million	5	$3 million	No expansion at present, but extremely popular in the Chicago market.
Gabby's Barbecue	$10 million	12	$900,000	Five units opening this year in home market of Texas.
MacArthur Park	$9 million	3	$3 million	Owner Spectrum Foods plans slow expansion of one or two units a year.
Jilly's	$7.5 million	6	$2 million	One unit under construction, two scheduled to open, eventual penetration of Washington, D.C.
R.J.'s the Rib Joint	$7.5 million	2	$4 million	Parent company recently acquired by Far West Services. Expansion likely, but plans not firm.

**Estimated by Restaurant Business*

quired by Diversifoods, which refined menu, preparation, decor, and operations, and began expanding in 1981.

There are now 46 company-owned and franchised Luther's, primarily in the South. Plans call for 90 openings in 1984, most in the latter half of the year.

At Luther's, customers walk through a cafeteria-style service line where meat dishes are prepared as they watch. In addition to barbecued beef and chicken, the restaurants offer hamburgers, baked potatoes, french fries, onion rings, baked beans, and dessert. Average check runs about $4.

Luther's serves a Texas-style barbecue, and has come up head-to-head against the problem of regional preferences.

Units average $1.3 million in annual sales, a fact that has inspired other restaurateurs to imitate the concept. One very similar concept is Kansas City-based Chap's, owned by former Rax Roast Beef franchisee Bob Gontram.

Emil Villa's Original Hick'ry Pit (in business since 1928) is Clorox's entry into foodservice. The company now operates 11 units, nine in the San Francisco Bay area and two in Seattle. Expansion plans are on hold while the concept is refined, says general manager Mike Kwiatkowski.

Chicken, ribs, sirloin of beef, turkey, and pork loins are cooked over a hardwood fire in a display pit. Kwiatkowski explains that Emil Villa's process is more similar to backyard barbecue than to Southern slow smoking. The grilling gives the meats a very light smoked flavor, and customers add barbecue sauce to taste.

The restaurants also serve 20 varieties of pies baked fresh daily, fresh-baked Danish pastries, and specialties such as crab sandwiches and sourdough bread. Emphasis is on quality says Kwiatkowski; hamburger and sausage are ground on-premise, dressings are made from scratch, and french fries are cut fresh. Price range is from $2.85 for a full breakfast to $10 for a steak, with an average check of $4.50 at lunch and $7 at dinner. Unit sales volumes of from $1.7 to $1.9 million are not uncommon, says Kwiatkowski.

A more typical Southern barbecue concept planning expansion is Sonny's Bar-B-Q, based in Gainesville, Florida. Sonny's posted sales of $58 million in 1983, with average unit volumes of $950,000 for 58 units, 55 which are franchised. Units are clustered in Florida, with some located in other Southeast areas.

Like Luther's, Sonny's has also run into the problem of regional preferences. Owner Sonny Tillman gave the go-ahead for a franchisee to try to make barbecue according to local tastes, but the attempt backfired and the units closed. Sonny's now sticks to the style the cooks know best, whatever regional preferences may be.

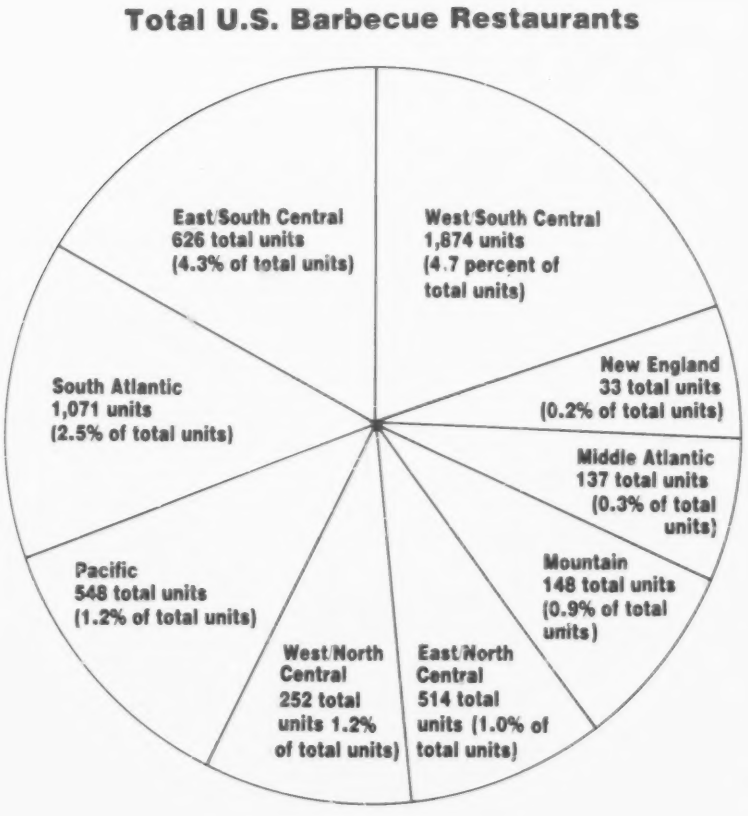
One of Sonny's chief competitors in Florida is Fat Boy's Bar-B-Q, also gearing up for expansion in the Southeast. The company, based in Cocoa, now has 39 franchised units and 10 company-owned stores with sales of $22.5 million, according to Bradley. The average unit grosses between $600,000 and $750,000. Some units gross in excess of $1 million, he adds.

Fat Boy is adding only four units in 1984 because of reorganization in preparation for major expansion. Plans in 1985 call for 25 new units, all franchised.

An important part of Fat Boy's growth will be from a new fast-food, drive-through prototype unit seating only 64, compared to full-sized units

continued on page 118

Gainesville, Fla.-based Sonny's Bar-B-Q hopes to expand into other areas of the Southeast.



5,203 total U.S. units
(1.8 percent of total U.S. restaurants)
Source: Restaurant Consulting Group
RE-COUNT, Spring 1983

franchised unit each in San Antonio and Albuquerque. Three more franchised units will open this year in San Antonio, Austin, and Albuquerque, and two more company-owned units in Houston.

"When we opened Gabby's in 1978, we felt there was a need for barbecue served in more upscale surroundings," says Gabby's president Frank Roche. "We also were aware that there were no major chains to compete against us in barbecue, unlike in pizza."

Gabby's service is cafeteria style, with average check running $5. The typical unit seats 175 people, with average annual sales of $900,000.

Roche points out that Houston has over 150 "mom and pop" barbecue restaurants offering varying degrees of product and price. "I think that as the market becomes more sophisticated, you'll see some of these places having a hard time," he says.

The image of these barbecue independents is generally of restaurants which feature uninspired decor but serve up mouthwatering barbecue cooked by the owner in a pit behind the restaurant. This image is epitomized by Kansas City's Arthur Bryant's.

Arthur Bryant's is situated in an inner-city location that is predomi-

continued on page 122

with a 167-seat average and 70 optional banquet seats.

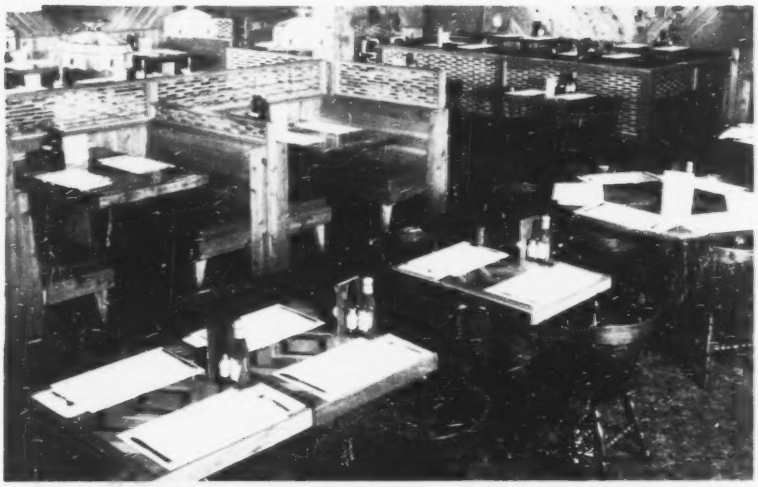
Full-sized units cost between $650,000 and $750,000 to construct and equip, says Bradley. As a result, they must be located in metropolitan areas to insure adequate return on investment. Smaller units will cost between $340,000 and $480,000, and will allow Fat Boy to penetrate smaller urban markets.

Menu prices at small and full-sized units will be comparable, adds Bradley, with an average check of $3.70 at lunch and $4.96 at dinner.

Another regional chain with plans for expansion is Houston-based Gabby's, a wholly owned subsidiary of Restaurant Developers, Inc., which also owns Spanky's Pizza.

The company operates 10 company-owned units in Houston, and one

Spectrum Foods operates three McArthur Park restaurants in California.



An aggressive franchising program will add 25 Bobby Rubino's in three years.

Diversifoods plans to add 90 Luther's, primarily in the South, by year-end.

nantly black. The linoleum floor runs downhill, tables don't match, and walls need fresh paint. But none of that keeps businessmen, students, travelers, and even ex-President Jimmy Carter from standing in a very long line for very large portions of sliced beef and pork or ribs, served with tangy sauce and cold beer.

What is happening to Arthur Bryant's, however, may be a harbinger of the future of barbecue. When owner Bryant died recently, several Kansas City businessmen purchased the restaurant and are now developing franchising plans. Spokesmen for the company, headed by LeRoy Bailey, say that it is too early to divulge details.

Many independents in the Barbecue Belt don't fit the stereotype, however. Restaurants like Bodacious in Longview, Texas, Loeb's and Coleman's in Memphis, Texas State Line in Atlanta, and the Hickory Log in Dexter, Missouri, boast annual revenues that would make a chain operator envious.

The Hickory Log, for instance, grosses about $1 million annually in a 400-seat unit, in a town of only 7,000 people. Customers drive from Arkansas, Illinois, and Tennessee. Many make the 150-mile trek from St. Louis. Others fly in to take loads of ribs home.

The Hickory Log, owned by John and Anita Banken, built its reputation on selections like barbecued baby back rib dinners for $5.95, barbecued sirloin of beef for $6.25, and sliced barbecued pork shoulder for a reasonable $3.95.

Five pits fire up at 7 a.m. every morning, and five men work shifts through the day cooking meat coated with a dry spice mixture. Ribs slow-roast for three hours in the pit and are always served fresh from the fire. Sauce is served at the table.

Gourmet barbecue

California's R.J.'s the Rib Joint, Hog Heaven, and MacArthur Park are a far cry from the South's barbecue barns. They might be called "gourmet" barbecue. Though the barbecue product itself is typically deep pit smoked, surroundings are definitely upscale.

R.J.'s the Rib Joint serves a full menu of barbecued beef and pork ribs, barbecued chicken, barbecued pork chops, barbecued veal, and even barbecued duck. Founder Bob Morris likes to call R.J.'s "The Cadillac of the market," and an average check of $15.50 without liquor lends substance to that claim.

The two R.J.'s, located in Beverly Hills and Newport Beach, CA, are part of Morris' company, called Mor' Food 'n Fun, acquired a year ago by W.R. Grace. Morris says he believes that a new franchising deal between W.R. Grace and New York's Riese Organization will include two or three R.J.'s in New York City.

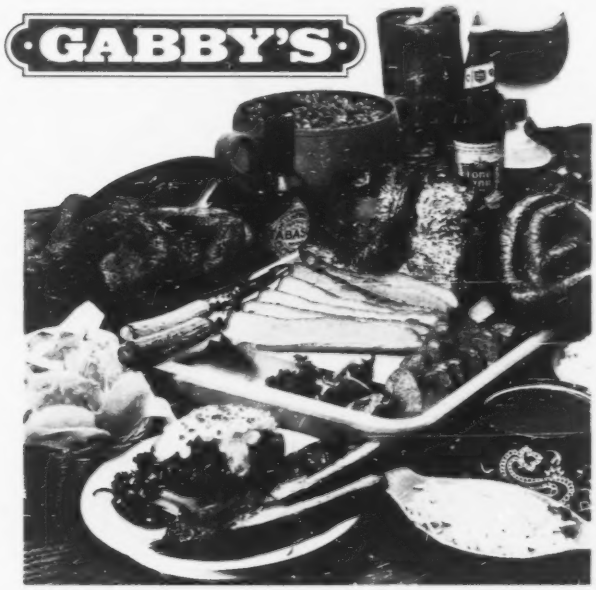
R.J.'s smokes its meat in a deep pit with a blend of orange, oak, apple, and alder wood, along with some hickory and mesquite. The restaurant offers champagne and macadamia nut sauces as well as barbecue sauce. Entrees, ranging in price from $9.95 to $15.95, come with an elaborate 70-item salad bar.

Entertainment, plus made-on-premise ice cream, fresh-squeezed orange juice, and 12-in.-high cakes, have contributed to annual revenues of $3 million at one unit and $4.5 million at the other, says Morris.

San Francisco's two Hog Heavens—one across from Golden Gate Park and one in the financial district—are the brainchild of Andrea Martin, originally from Memphis.

Each morning at 7 a.m., Hog

continued on page 126



Houston-based Gabby's offers cafeteria service with an average check of $5.

Heaven's cooks begin stoking the hickory and mesquite wood fire. Pork shoulder, a specialty of the house shredded for a Memphis sandwich or piled in mounds for a platter, is cooked for nearly 10 hours.

Side dishes include cole slaw, cornbread, barbecued beans, deep-fried potato slices, onion rings, and such desserts as black bottom, key lime, and pecan pies. Price range is from $4.50 for a Memphis sandwich to $11 for a plate of barbecued shoulder, sausage, chicken, ribs, slaw, beans, and cornbread.

The first 70-seat unit, opened in July of 1980, grossed $1 million its first year. Now Martin plans to open units in Portland and Seattle, and then across the northern U.S. to the East Coast.

Despite the "down-home" cooking, the restaurant's ambience is upscale. Just inside the black canopied facade is a long bar festooned with original "pork-traits" showing pigs in historic poses: Napoleon Bonapork, Porkahontas, Louis the Porkteenth, Pignic in the Grass, and Attila the Hog.

Another upscale barbecue concept is MacArthur Park, which opened in San Francisco in 1972. A second opened in Palo Alto in 1981, and a third this year in Huntington Beach. The restaurants are owned by Spectrum Foods, which also owns Prego, Ciao, Chianti, and Harry's Bar & American Grill in San Francisco and Los Angeles areas.

Like other Spectrum restaurants, the three 200-seat MacArthur Parks specialize in "California cuisine," such as cold smoked albacore and salmon, fresh Petaluma duck, rabbit, Maine lobster, and Eastern dry-aged steaks. More than 50 percent of sales come from back ribs, chicken, sausage, pork chops, and duck basted and smoked in MacArthur Park's own specially designed oak wood smoker, then broiled quickly over mesquite.

Price for a rib dinner, served with cole slaw and french fries, is $12.

President Larry Mindel calls MacArthur Park "the proverbial turtle in the race with other rib places," because the company plans to open only one or two units each year. Each MacArthur Park posts sales in excess of $3 million a year.

Rib restaurants

Restaurants specializing almost exclusively in ribs tend to occupy a niche below an upscale dinner house but above most of the expanding family-priced barbecue chains. They are casual, often provide entertainment, do a thriving liquor business and appeal to a broad base of families and singles.

Barbecue purists sniff at some of these concepts, which sometimes rely on sauce alone for flavor instead of opting for a long smoking process. Others use a more traditional method, but most are quite secretive about their cooking processes. A great many specialize in baby back ribs, cut from the back portion of the lowest seven ribs on a pork slab.

The acknowledged leader of the segment, and the company that spawned a host of imitators, is Tony Roma's—A Place for Ribs. The company operates 37 units, 20 of them company-owned and joint-ventured, from Hawaii to Florida. The company has even taken ribs international with units in Canada, Japan, and the Bahamas.

John Knight, vice president of marketing, says that Tony Roma's owner, wealthy Texas businessman Clint Murchison, sees plenty of growth potential in the ribs segment. As a result, the company is positioned for aggressive expansion.

"Over the past three months we've opened six new restaurants, and we would like to maintain that pace," says Knight.

Tony Roma's widely-copied format—a limited menu specializing in baby back ribs at $9.95 a portion, served fast and friendly—resulted in 1983 systemwide sales of some $60 million. Average store volume runs $2 million, says Knight.

Knight professes to be unconcerned about the many competitors who frankly admit their concepts are copied after Roma's. "Nobody has been able to significantly affect our performance to date," he says. "However, we do keep a close watch on our direct competition. No doubt in the future they will become a greater concern."

Typical of these competitors is Bobby Rubino's Place for Ribs, with 16 units seating between 225 and 250. Nine are located in Florida, three in New Jersey, two in Pennsylvania, and two in Canada. The company recently signed an agreement for 13 stores in Chicago in the next seven years, with the first store opening in September in Woodmont. Agreements have also been

continued on page 130

Barbecue *continued from page 126*

signed for development of the Atlanta and Savannah markets, says Jerry Moniz, director of operations for franchising.

"We project another 20 to 25 units in the next three years, with 70 percent of that growth through franchising," adds Moniz.

Bobby Rubino's menu price range is from $3.95 to $15.95 for a prime rib or a "Steel City" 2½ lb. rack of ribs. Sixty percent of food sales derive from ribs, says Moniz, but he will not divulge average unit volume or total company sales.

Jilly's, another Roma lookalike, dominates the Atlanta ribs market with three units and another under construction. Units are also located in San Antonio; Atlantic City; and Columbus, Georgia. Ken Eppard, director of operations, predicts slow expansion, with an additional two company-owned units opening soon and eventual expansion into the Washington, D.C., market.

In response to higher pork prices, Jilly's has expanded its menu by adding lamb ribs, which presently account for about 15 percent of sales.

Total company sales in 1983 were $7.5 million, with the two Atlanta Jilly's always averaging more than $2 million apiece, says Eppard. Average check is about $11.

Oh! Brian's operates units in Charlotte, Greensboro, Winston-Salem, Raleigh, Durham, and Fayetteville, North Carolina; Chattanooga, Tennessee; and Roanoke, Virginia. The restaurant chain is a subsidiary of Investment Management Corp., a holding company that also owns Golden Corral Family Steakhouses, Sirloin Stockades, Fred Gang's dinner houses, and Nicho's Mexican fast food units.

Like Tony Roma's and the others, Oh! Brian's specializes in baby back ribs with an average check, with liquor, of about $10. Average unit volume is $1 million, Sink says.

The granddaddy of rib restaurants in the Chicago market is Carson's, The Place for Ribs, which operates five units in the Windy City's metro area. The company currently has no plans for further expansion, says Donna Giannis, corporate secretary.

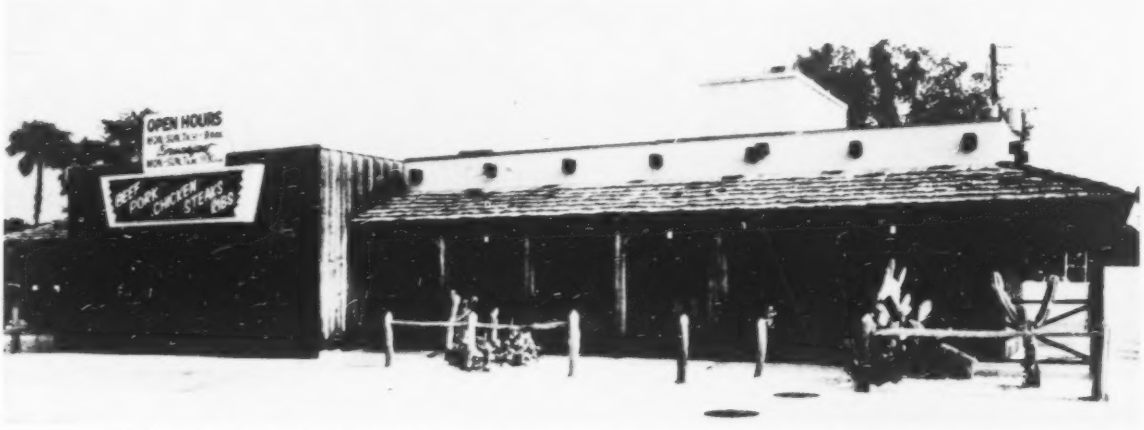
Carson's offers a full 1½ lb. to 1¾ lb. slab of baby back ribs for $12.95, and 85 percent of customers order ribs, Giannis says. Carson's also sells some 9,000 carry-out orders a week, at $1 off the menu price.

Carson's units vary in seating from 120 to 190. The atmosphere is slightly more formal than at a Tony Roma's, with white tablecloths and linen, but the feeling is anything but stiff. The combination works: the chain posted sales of $15 million in 1983.

A small chain positioning itself for growth is Philadelphia-based Rib-It, with five company-owned units in Philadelphia, Atlantic City, Washington, D.C., and Cherry Hill, N.J., and a new franchise unit in Manhattan. Sales in 1983 were $5 million on five units. Owner Paul Rimmeir projects that the chain will have about 30 company-owned units and 40 franchised units in five years.

Fat Boy's is planning a new fast food drive-through prototype.

Rib-It serves large portions in an atmosphere of natural wood, stained glass, and mirrors. In addition to barbecued baby back ribs, barbecued chicken, barbecued spare ribs, and barbecued veal ribs, the restaurants serve sandwiches, baked Cornish hen, fried clams, fish and chips, fried shrimp, and a marinated flank steak. A plate of barbecued baby back ribs with steak fries and cole slaw is $6.95, even in the Manhattan unit. The highest price is $12.95 for a rack of barbecued veal ribs. □



With minimal expansion this year, a reorganization plan will enable Fat Boy's to add 25 units in 1985.

MERGERS & ACQUISITIONS

Growth through acquisition may be the key to expansion in the foodservice industry today. On the following pages, *Restaurant Business* profiles four of the prominent players in the mergers and acquisitions market: Saga, Diversifoods, Vicorp and R.J. Reynolds. In each case study it becomes clear that no two companies are alike in their goals or strategies. However, these companies share a determination to expand in order to assure a secure future for the company, its managers and stockholders. A select listing of foodservice concerns involved in merger and acquisition activity follows the profiles. The list spans February, 1979 through June, 1984.

← For information circle number 87

By acquiring Ron's Krispy, Church's made its first move into the higher check average chicken segment.

Acquisition activity in the foodservice industry has changed since *Restaurant Business* took its last look at the "corporate mating game" six years ago. Times have changed, the industry has matured, and the reasons behind two companies joining hands via an acquisition or merger have become more complex. The buying boom of top segment performers by non-foodservice concerns—à la PepsiCo's acquisitions of both Pizza Hut and Taco Bell just three months apart in the 1970s, or even Pillsbury's move on Burger King in the late 60s—has slowed in recent years, just as surely as the industry's wild growth of last decade has cooled.

Not that the 1980s are an inopportune time for such transactions. On the contrary, the economic and political climate under President Reagan is very favorable toward merger and acquisition activity. Many companies are taking advantage of this administration's pro-industry tax and antitrust policies. In the past year, interest rates too have been more conducive to leveraging acquisitions. In the first quarter of this year alone, the number of "business combinations" rose 31 percent to 710 from 540 a year earlier, according to W.T. Grimm & Co., a consulting firm.

A chart appears on page 169 which lists many of the key mergers and acquisitions in the foodservice industry over the past five years. Last year shows a marked increase in activity, supporting data which claims that merger activity is on the rise. A total of 17 chart entries took place in 1983, slightly more than 50 percent of total entries.

Among some of these are Kelly-Johnston Enterprises' acquisition of Duff's, the smorgasbord chain, for $18 million in cash and stock; W.R. Grace & Co.'s purchase of the smaller concerns, T.J. Applebee's and Mor Food 'n Fun for an undisclosed amount; the $308 million merger of Chart House and Godfather's Pizza and others. Church's also acquired Ron's Krispy last year for $7.5 million; Denny's moved to snatch El Pollo Loco for $11.3 million; and Saga grabbed up Grandy's for $66 million and Spoons for $3 million. Of the select group covered in the *Restaurant Business* chart which records the value of their transactions, total reported transactions for 1983 alone were valued at $573.8 million.

However, these are not the days of giants buying other giants where the foodservice industry is concerned, or of non-related conglomerates buying into the business in a big way. Rather, these are the days of foodservice companies buying other foodservice companies, and of diversification in one's own industry. These are the days of larger, more established restaurant companies taking over smaller growth companies which have the desire—but not the capital—to grow; the days of buying out the competition rather than fighting with it; the days of buying into a new geographic area rather than building it; and the days when maturing franchisors may opt to buy out franchisees so that their own assets are improved by adding prime sites at a lower cost.

If the 80s stand for only one thing in the restaurant industry, it is the struggle to expand in an increasingly competitive and difficult marketplace. And many participants—both on the buying and selling side—have decided that combining forces with another company is the surest and quickest road to growth.

Signs of a change

Last year's merger of Chart House and Godfather's Pizza was a sign that the market still has some surprises up its sleeve, and that larger merger activity in the industry is returning. But to a greater extent there are precious few transactions of that size occurring today.

According to Michael Culp, industry analyst with Prudential-Bache Securities, the reasons for this hiatus are three-fold. "Both the recession and interest rates made it difficult for companies to consider large transactions," says Culp. "But another reason for caution on the industry's part had its roots in the PepsiCo/Pizza Hut and Taco Bell deals. Pepsi had problems digesting both companies and it is generally held that when Pizza Hut joined up its per share earnings had already peaked. Pepsi's experience soured the market for making 'The Big Deal' as a result."

However, Culp suspects there will be a rise in takeovers—large and small. "I think we're in the early stages of a new boom in takeover activity," says the analyst. "Many established chains are selling at depressed prices that are well below their replacement value. Those values should not be measured by real estate prices. Name recognition, market position, and management experience are just as important. Moreover, because stocks have been depressed, an unfriendly takeover becomes more likely; management wouldn't want to voluntarily sell out for less than the company is worth."

Guessing what some takeover targets might be, many analysts point to Church's, which has for some time been the subject of speculation—both knowledgeable and oth-

erwise. With a shakeup in management last year, and a lengthy process of replacing top officers the fried chicken chain is viewed as a prime candidate for takeover. Wall Street insiders say that on at least one occasion a deal was about to be locked up when it hit a snag.

"Ralston-Purina and Church's were just completing negotiations for an acquisition when Church's stock went crazy," says one Wall Street analyst. "It was all set, but the stock's rising price made the suitor back off."

Other speculation on Church's being on the selling block leads to Hardee's. According to company insiders, Church's newly elected president, Rick Sherman, became familiar with the company and its chairman J. David Bamberger while the hamburger chain, thinking of diversifying, was negotiating for a takeover. The deal never materialized, and some time later Bamberger hired Sherman—then right hand man to Hardee's chief Jack Laughery—to head up the chicken chain. But speculation still abounds.

A more disciplined approach

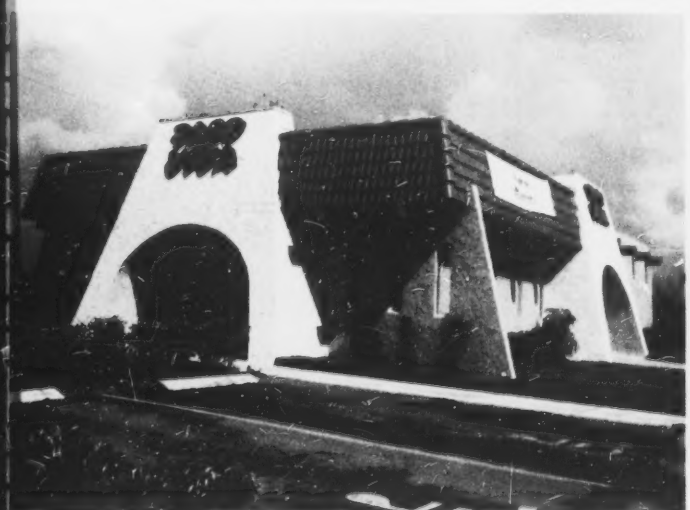
The corporate mating game has come to entail a specialized and sophisticated approach to planning the future around developing growth concepts. Careful strategic planning—Exactly where does this concept fit into our overall corporate plan?—outweighs diversification for its own sake. The country has been through one of the worst recessions in its history, and has struggled with record-high interest rates. Economic conditions the past few years have left corporate America cautious, with a more disciplined philosophy toward expansion through acquisition. Buying into unrelated industries is a practice many companies widely avoid, for example. The practice can be risk-ridden and costly.

> Due to the difficulty of expanding in a highly competitive marketplace, many foodservice companies—both on the buying and selling side—have realized that combining forces is the surest and quickest road to growth.

"It is very difficult to integrate a company when you know very little about its business," says Geoffrey D. Lurie of the consulting firm Touche Ross & Co. "The key to making an acquisition today is buying a company in a related business, and preferably buying it with its management in-place. Making the decision to diversify is relatively simple, and in the foodservice industry it becomes more essential that companies consider such a move. The problem, however, is targeting the right company to go after, and then integrating the new company into your own. That is the point where theory breaks down and the real world comes in. The transition occurs much more smoothly, the long range results are far better if there is familiarity."

According to Roger Magid of Touche Ross, the most successful integrations have occurred when both parent and subsidiary are able to function autonomously. "Decentralization of management is of paramount importance," he explains. "Particularly when you have a small, entrepreneurial company used to making decisions just a few months out, being swallowed up by a huge corporation used to making strategic plans for five years down the road. If the new acquisition can function independently, the 'us versus them syndrome' can be minimized."

That, say observers and participants alike, is why buying a company's management as well as its assets becomes extremely crucial. The most successful business combina-



Taco Viva acquired Paco's Tacos for conversion; Dairy Queen diversified with Golden Skillet purchase.

tions have been the result of one company buying another intact, so that the new subsidiary can continue—as much as possible—as a separate entity without missing a stride.

Without a doubt, the driving force in today's acquisition market is the portfolio approach. Protect yourself—from changing consumer tastes, from commodities price fluctuations, and from competition—by crossing over into other concepts and segments. If you can diversify your customer base, you will become more recession-proof and get a larger share of the market.

"McDonald's does not talk about this publicly, but there is talk that the company is now considering diversifying," says Culp. "The very fact that McDonald's is thinking about branching out—regardless of whether or not they actually do anything soon—is a big step. It says something very profound about the state of the industry today. Ten years ago, McDonald's would never have been the subject of such speculation."

Of course, it is the larger, more mature single-concept chains that diversification seems more critical to. Plagued by the prospect of saturation, branching out with another concept is about the only way to ensure continued long-term growth.

Just a few months ago, Burger King chief executive J. Jeffrey Campbell announced that he was restructuring top management, and one of the reasons for his move was to begin planning for diversification. Through an acquisition, Burger King will be entering a non beef-intensive segment, somewhat like Wendy's International opting for diversification with its Sister's Chicken & Biscuits concept. A Burger King spokesman says that the Miami-based hamburger giant will probably opt for acquiring a regional pizza chain with growth potential, then begin expanding it rapidly.

Major industry participants, like Saga for instance, learned early on that the successful restaurant company of the 80s and beyond is one which depends not on a single concept, but on several. Saga's acquisitions of Grandy's and Spoons last year marked its entry into two growing segments—upscale chicken with Grandy's and gourmet hamburgers with Spoons. The Menlo Park, Cal.-based industry leader has become an extremely diversified company over the past few years, and acquiring restaurant concepts has been a major part of its strategy (see page 153).

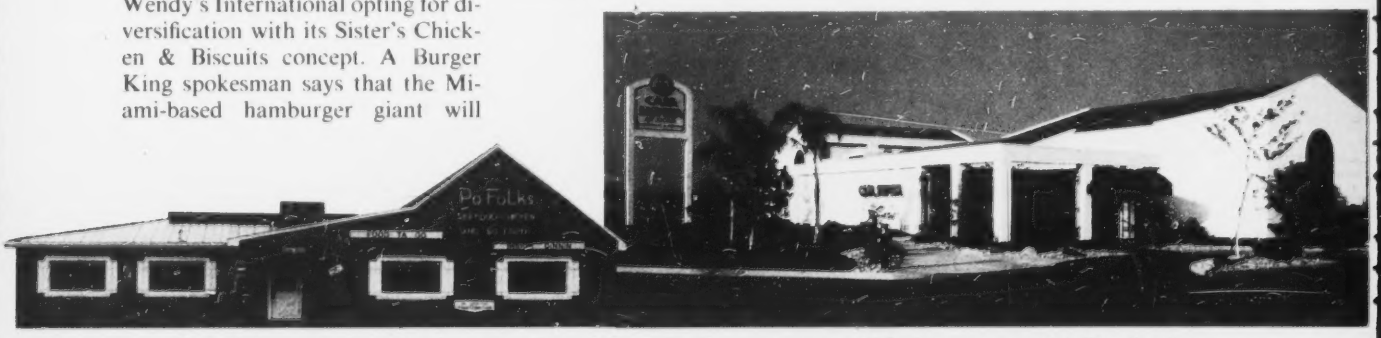
Mature companies like Denny's, which can be hard-pressed to continue growing, have opted to acquire high-growth concepts with the potential for national appeal. The company last year acquired development rights to the fledgling El Pollo Loco concept, which features charbroiled chicken with a south-of-the-border flair. With company-built Denny's unit openings sagging to only 40 a year and Winchell's Donut House units dropping, the El Pollo Loco move allowed Denny's opportunity to pour much of its $100 million a year in available cash into expanding a new market niche. The concept's low food and labor costs and high returns on investment, along with its appeal to lighter eating tastes, made El Pollo Loco a perfect strategic fit.

According to Denny's president and chief executive officer, Vern O. Curtis, Denny's acquisition days are over however. "We want to have a dominant position with the concepts we now operate—family restaurants, donut houses, and non-fried chicken—rather than have a whole set of subsidiaries," says Curtis. "Until we are as strong as we can be in the segments we're already in, we won't be acquiring any more concepts." Curtis, along with other Denny's managers, is in the process of negotiating a leveraged buyout of the company (see page 151).

Collins Foods International (CFI) is adding some 80s-style spice to its successful but rather well-worn portfolio of Sizzler Steak Houses and franchised Kentucky Fried Chicken operations. CFI's chairman, James A. Collins, is committed to doubling the company's revenues within the next four years—fiscal '83 sales reached $448.9 million—but believes that growth and improvements in KFC and Sizzler alone will not be enough.

CFI first turned to internal development, but its Southside BBQ, Lumber Camp (upscale steak houses) and Goose Creek Food 'n Fixins (a Southern home-style food concept) experiments were rapidly scuttled due to poor performance.

As a result, the company has taken a different route to diversification: Through acquisition and joint venture, it has come in on "ground floor-level" projects in the pizza, upscale hamburger and Mexican segments, using the cash generated by KFC and Sizzler units to fund the projects. When CFI acquired Chicago's Gino's East pizzeria for $2.5 million last November, it acquired recipes, a name, and a reputation. With Rich (Lettuce Entertain You) Melman, CFI is putting the finishing



Krystal Corp. sought national presence through Po Folks; Ponderosa entered Mexican segment with Casa Lupita.

touches on a duplicable chain concept, which is being debuted in home-base Southern California this summer. Eventually, the company hopes to use its considerable expertise as both franchisor (of Sizzler) and franchisee (of KFC) to begin licensing Gino's, likely to begin in CFI stronghold Australia.

CFI also owns a 60 percent interest in Ed Debevic's Short Order Deluxe, a hamburger cafe concept developed by Melman and Big 4 Restaurants co-owner Lee Cohn. Through a joint venture, CFI has provided the entrepreneurs with the capital to fine-tune the first three units, and CFI will begin opening its own Ed Debevic's as a licensee.

This year, CFI's majority-owned Sizzler subsidiary acquired the recipes and development rights to a family-oriented Mexican concept called Emma's, which will be used as an adjunct concept and conversion vehicle by steakhouse franchisees.

All told, CFI will triple capital expenditures to about $175 million in the next three years, about a third of which will be spent on the three new concepts.

Adds Collins: "We need to make another acquisition in the next few years in order to fuel this growth, but so far no one wants to dance." Seafood has been mentioned as just one possibility. "The most important element of an acquisition is the people-fit," says Collins. "Of course you're looking for as little earnings-per-share dilution as possible in a transaction, but if the concept is great and really has the potential to grow, and you've got people that you've got confidence in, does it really matter if earnings per share drops from $2 to $1.90 for a while?"

According to Wall Street, a good price for an acquisition in the foodservice industry is 15 times current year earnings (about 6.5 to 7 times after tax earnings). However, says Culp, "You've also got to look at other things like management and growth potential—it isn't that clear cut." Regarding earnings per share dilution, Culp cites the Godfather's/Chart House merger as questionable. "People have been a little sour on the merger because the EPS dilution was 20 percent. That's higher than it should be and can be seen as risky, but I still maintain that the overall transaction was a good one.

Beginning on page 153 are profiles of four of the most prominent players in the mergers and acquisitions market: Saga, Diversifoods, Vicorp, and R.J. Reynolds Industries. In studying each, it becomes clear that no two companies are alike in either their goals or execution when putting together a deal. But it becomes equally clear that each company, determined to expand in order to secure future health for the company, its managers, and stockholders, views growth through acquisition to be key in the foodservice industry today. Following these profiles is a select list of about 30 foodservice concerns involved in merger and acquisition activity. The list spans 1979 through June, 1984, and focuses on the larger transactions.

What the listing does not include are those purchases involving franchisors and franchisees. As good sites become difficult to develop, a growing trend toward franchisors acquiring franchisees is developing.

"You've got a franchisee with a certain territory granted him, and once he's developed his area, there's not much more he can do," says Richard L. Chilton, Jr. of Allied Capital Management. "The franchisor may be able to buy that person out and keep his own earnings growth up as a result. As the market is now, the price to buy back a franchised store is about half the price of building your own unit. It's a very effective way for a franchisor—who can be hard pressed to expand any further if his concept is a mature one—to keep up a good earnings trend." Chilton cites Burger King's setting up a corporate development program, with one of its major concerns being the buying back of franchised units. "The site factor is an important one today," says Chilton. "The world gets smaller every day."

RA acquired 40 percent of Acapulco y Los Arcos; Pillsbury entered ice cream segment with Haagen Dazs.

SAGA

Flexibility fosters future growth

Saga today is markedly different from the company it was 10 years ago.

With an emphasis on accelerating revenue growth rates and maximizing its management resources, Saga has successfully grown beyond its contract foodservice beginnings to become a restaurant portfolio company whose presence in the market is approaching a national scale. The Saga of the 80s is a multi-faceted consumer services company, designed with flexibility to take advantage of opportunities as they arise in several segments of the foodservice industry.

The company's restaurant operations encompass several distinct chains—Velvet Turtle dinner houses, Stuart Anderson's Black Angus/Cattle Company steak houses, Grandy's upscale chicken restaurants, and Spoons gourmet hamburger cafés—plus a new Restaurant Management Division serving the lodging industry.

And in a striking example of Saga's commitment to optimum use of its financial and management assets, the company announced plans in late June to divest Straw Hat Pizza, the organization that brought Saga its first entry into the public foodservice sector in 1969. With annual revenue growth in the nominal range of six to seven percent, Straw Hat is simply not a strategic match for Saga's new top-performing Grandy's division, with 65 percent annual growth.

In fiscal 1984, ended June 30, all of the company's divisions experienced improvement, including the corporate foodservices, education health care, and Canadian divisions comprising Saga's contract segment.

It has not always been so. The company began life in 1948 as a contract feeder, and today continues to count nearly two-thirds of its revenues from this business segment. Yet while Saga had diversified its account base and had established restaurants as its second line of business in 1969, the company began to see its bottom line eroded by rising commodities prices in the late 1970s.

Strengthening results in the contract segment was only part of the turnaround strategy implemented by chairman and chief executive officer Charles A. Lynch. Gaining a position in less price-sensitive areas than contract feeding was also vital.

Lynch has spearheaded a corporate restructuring and diversification program that positions Saga as broad-based consumer service organization with a retail orientation. Much of that repositioning has come through well-planned acquisitions in public foodservice, notably those of Grandy's and Spoons in mid-1983.

Saga chairman and ceo Charles A. Lynch.

Historically, Saga has often grown and broadened its business base through acquisition. This has been particularly true in the company's restaurant segment.

In 1971, two years after it had formed Straw Hat Pizza through the acquisition of two small pizza operations, Saga bought the five-unit Velvet Turtle dinner house chain. The following year, Saga acquired the nine-restaurant Stuart Anderson's Black Angus group, now Stuart Anderson's Black Angus/Cattle Company Restaurants. A third chain, the 18-unit Refectory acquired in 1973, was a further extension of Saga's strategy of buying small growth-potential chains, rather than starting up new operations. (The Refectory was later divested, because it no longer offered adequate return and expansion opportunities.)

But none of these concepts could offer the sweeping growth potential and high return on investment that Saga needed to burst out of its slump. For Charles Lynch, brought in as president and chief executive officer of Menlo Park, California-based Saga in late July of 1978, the immediate task was one of improving profits. The Refectory—which competed for customers with Black Angus—was sold, and an underperforming, internally developed concept called The Wild Strawberry was scuttled. Improvement programs were implemented in the areas of overhead expense controls, pricing strategies, productivity, purchasing, training and development, and cash and asset management. Unit expansion during this period was nominal.

In early 1982, the company was

restructured in preparation for growth. Lynch, named chairman in January of that year, created a four-man Office of the President. Three key executives, each with specific areas of responsibility, were designated to share that office with Lynch: Jeffrey O. Henley, James W. Morell, and Carl H. Randall. In addition, Lynch moved 25 corporate managers into new or redefined positions, energizing the entire top structure of the company with new assignments.

Saga approaches the process of targeting acquisitions by first determining what new segments make the best "fit" with existing operations.

"We work to really understand the businesses we are already in first," explains Lynch, "before we even consider acquisitions. We begin by analyzing our opportunities with existing portfolio components, but we also realize that not every one of our existing businesses is destined to be the 15 percent annual growth format that we feel is optimal. The question becomes: What should we be looking for to fill these gaps? What formats are evolving that would fit in with our existing businesses? We don't want to compete with ourselves in the true sense of the word by having overlapping segments or by going after the same customer."

Upscale, quick service formats emerged as likely candidates through this process. Noting sweeping changes in customer demographics and lifestyles, as well as attractive returns associated with the emerging upscale fast food and adult-oriented hamburger chains, Saga began to pursue acquisitions in those segments in late 1982.

Explains Lynch: "In selecting a target, we screened several hundred, and talked to just a handful. You have to boil it down and analyze the possibilities before you even begin to negotiate."

Lynch refers to this process as a filtration system. Tantamount to the success of the system, he asserts, is a set of well-defined guidelines. These New Business Criteria, as they have also been called, stipulate that any new business—acquired or developed internally—should have:

- Net income of at least $4 million per year within five years;
- Five percent real market growth;
- Potential for market dominance within five years;
- Internally generated funds, capacity for additional debt;
- Return on assets (ROA) in excess of base business; and
- Business which does not further exaggerate seasonality of earnings.

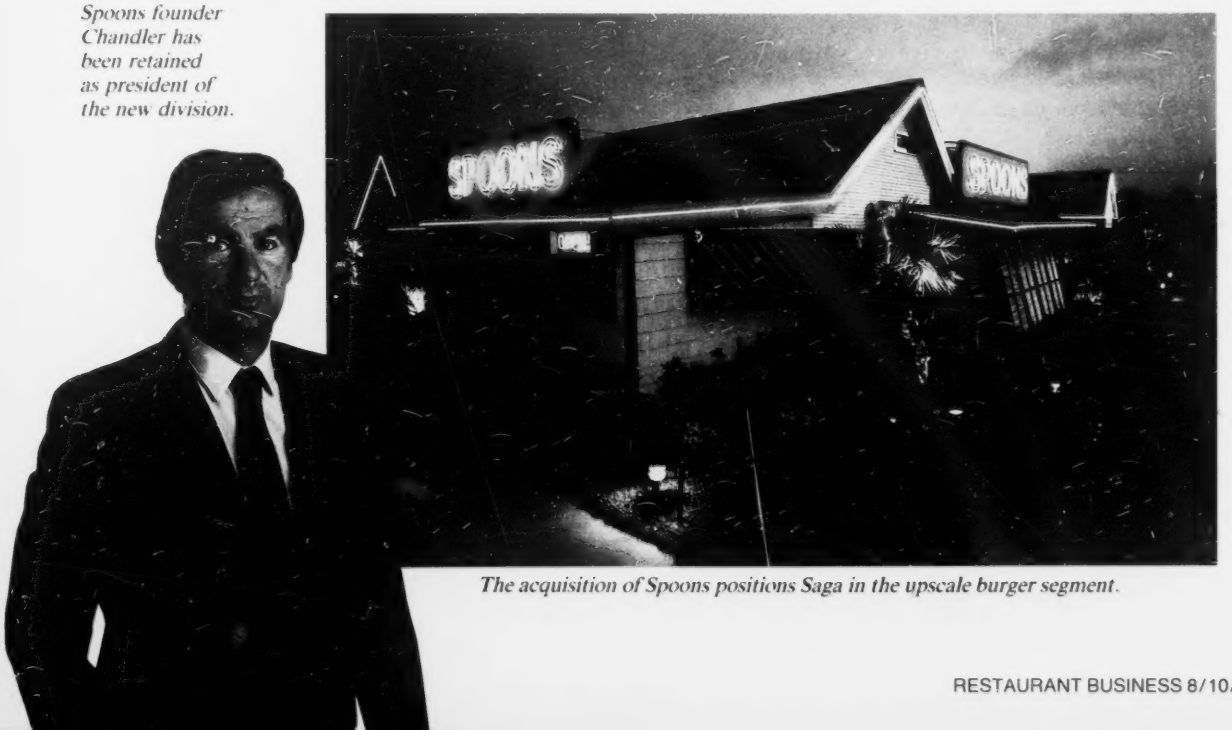
The reason for these criteria, says Lynch, is minimization of risk.

These guidelines enable Saga to weed out a number of possibilities, without wasting undue time at the bargaining table.

It turned out that Grandy's was a near-perfect fit. With 63 units and $27 million in revenues, the Lewisville, Texas chain of family-oriented chicken restaurants had for some time been quietly investigating its options for funding an ambitious expansion plan. According to Saga executives, Grandy's performance and management were "superb."

Grandy's was an established company with well-defined goals of its own. Founded by Walter E. (Ed) Johnson and Rex E. Sanders in 1972, the company was already in a heavy growth stage and had adopted a five-year expansion program which Saga found viable. In addi-

Spoons founder Chandler has been retained as president of the new division.



The acquisition of Spoons positions Saga in the upscale burger segment.

tion, Grandy's profile fit well with Saga's philosophy of allowing its operating divisions considerable independence and flexibility.

Says Johnson: "We wanted maximum autonomy over our operations. Our new parent had to have a track record of decentralization." Johnson and Sanders had been through one unhappy acquisition experience some years back when they sold out their first concept. Doubly cautious now, they had their own stringent set of criteria for a parent. The agreement was concluded on July 27, 1983, as Grandy's became a wholly owned subsidiary of Saga for a little more than 1.6 million common shares, valued at about $66 million.

Meanwhile, Saga was forging ahead in its attempts to make an acquisition on the gourmet hamburger front. In early 1983, the company had signed a non-binding letter of intent to acquire Chili's, which, with about two dozen units and average unit volumes well in excess of $1 million, is an acknowledged segment leader. Yet in June, the negotiations were called off as Chili's decided instead to go public.

Saga had already targeted Spoons as a second choice, and without missing a beat, went on to acquire the five-unit chain on August 18, 1983, for about $3 million.

In its acquisition of Spoons, Saga became parent to a company that could best be described as embryonic. With all five units in Houston, Spoons had sales of under $5 million and a management team that basically consisted of the founder (who goes by the single name Chandler) and two other people. Saga's first priority for the fledgling company was to place about half a dozen new people on its staff, particularly in site selection and marketing. In addition, Saga had some fine tuning to do to ready the Spoons concept for expansion.

As much as Lynch acknowledges that Saga was taking something of a risk considering the untried nature of the Spoons concept, he points out that, overall, buying was the least expensive way to get into the segment.

"The investment required to buy an emerging concept is relatively minor. And when you buy it, you're in business right away. You might need to make a few modifications, but basically you're buying an ongoing business."

The strategy for Grandy's and Spoons is one of ambitious and immediate expansion. Says Randall: "We plan to expand these concepts as fast as the market allows without jeopardizing the inegrity of the concepts." While the company declines to reveal long-range plans, fiscal 1985 will see the opening of about 30 company-owned and 50 franchised Grandy's, and about 10 to 12 Spoons. Franchise plans for the latter concept are also a future possibility.

The two new concepts will be heavy growth vehicles for Saga; Grandy's began contributing to per share earnings almost immediately (most acquisitions dilute earnings for a period of several years) and was expected to generate about $100 million in fiscal 1984 revenues. Black Angus and the Health Care division of Saga's contract segment round out the company's high growth portfolio. A base of over 1,200 contract accounts is supplying the cash and management to fuel this growth.

With this diversified portfolio of mature businesses, and a group of concepts that have high returns on relatively low investments, Saga seems destined for a secure future. And, says Lynch, Saga has not closed its eyes to future acquisitions. "Give me another Grandy's," he asserts, "and I'd have the checkbook ready." **—Joan Lang**

Grandy's co-founders Ed Johnson (l.) and Rex Sanders will operate the upscale chicken chain as an independent entity.

DIVERSIFOODS
A portfolio with a pizza topping

Last year's expeditious merger of Lafayette, La. based Chart House, Inc., and Omaha-based Godfather's Pizza, Inc., caused quite a stir in the industry. It also created one of the largest publicly traded restaurant companies in the U.S., with combined 1983 sales of $500 million. The combined entity, now known as Diversifoods, Inc., is among a growing number of "portfolio" companies in the industry, with five different restaurant concepts operating in nearly every state. Two of its concepts, Godfather's and Luther's Bar-B-Que, form the backbone of the new company, providing major growth opportunities.

The merging of these two companies may have appeared almost haphazard at first—not so much out of design as out of creative spur-of-the-moment vision. Two entrepreneurs—Chart House founder Billy Trotter and Godfather's founder Willie Thiesen—meet skiing one day in Aspen. Friendly conversation turns to business, and before long the two are talking deal. Soon afterward—and much to everyone's surprise—an agreement is signed, altering the futures of both companies practically overnight.

But there's more to it than that. The joining of Chart House and Godfather's was no convenient, friendly amalgamation designed by visionary entrepreneurs. It was a merger conceived out of mutual need between major foodservice concerns with a lot to gain from consolidating.

For one thing, Trotter needed a major growth concept added to Chart House's tiring portfolio. The company was—and still is—heavily dependent on cash generated by its 267 company-owned and 110 sublicensed Burger Kings. Its Cork 'N Cleaver steak house and Cisco's Mexican concepts were failing and on the verge of being eliminated. And its premiere growth vehicle, Luther's, was as yet unproven with only 45 units open in southern locations. All in all—and including the company's 51 upscale Chart House restaurants—every concept in the company's portfolio strongly relied on selling red meat. A major growth concept (preferably one which was not tied to beef prices) became critical. Godfather's fit the bill.

Godfather's, too, needed a change. Downward sales trends since 1982 concerned Thiesen so much that major management changes were being made to reverse those trends. The company had fallen well behind its competitors due to a very late testing of a pan pizza product, and had shown sluggish sales since being forced to eliminate its "Godfather" character from ads due to protests by the Sons of Italy. Thiesen decided he would need greater financial and management strength to secure the company's (and stockholders') future, and a merger with Chart House would accommodate both needs.

Gearing up for the change

In preparation for its own future growth—and prior to beginning talks with the pizza chain—Chart House had been laying the groundwork for a reorganization. Just four months before an agreement in principle was signed to merge with Godfather's, Don Smith was named president and chief executive officer of Chart House. At 43, Smith is among the industry's leading figures, having held the top positons at McDonald's, Burger King, and most recently PepsiCo's foodservice division, comprised of Pizza Hut and Taco Bell.

Smith's move to Chart House in May 1983 was the telltale sign that things were about to happen in Lafayette. His compensation package was directly linked to the company's performance, just as it is now linked to the performance of Diversifoods. Says one company insider, "Don Smith didn't come to Chart House to run its Burger King units." A major reorganization was to take place upon his arrival.

Godfather's was also in a changing mode prior to talks between Thiesen and Trotter. In 1982, nine years after opening its first restaurant, the company made its first public stock offering. Just weeks before signing an initial agreement with Trotter, Thiesen—handing over the reins for the first time since founding the company in 1973—brought in Chuck Boppell, to take over as president and chief executive officer. Numbering almost 900 restaurants, Godfather's had grown beyond Thiesen's control.

"I knew that my business needed professional management in order for things to keep going smoothly," says Thiesen. "That's not my expertise, so I had to bring in someone like Chuck to take over." Thiesen lured Boppell away from PepsiCo, where he headed the Taco Bell division and where he had worked before with

Smith. Boppell reportedly did not know he would again be working with Smith—via the merger—when he decided to work for Thiesen.

"The whole thing happened very quickly," says Thiesen. "It wasn't as if Godfather's was up for sale or looking around for a partner. I only spoke with Chart House, there were no other negotiations."

Putting together the pieces

Smith has assembled what many industry observers view to be among the most talented group of senior managers in the industry. That, coupled with his commitment to maintaining a well balanced portfolio of high growth restaurant concepts, is expected to secure steady growth for the new company.

"Diversifoods will be managed much like a successful investment portfolio, and for many of the same reasons," says Smith. "We're diversified by restaurant concept, by food items, by geography, and by management type. Additionally, the wide range of real estate locations we control means we can test and develop a new restaurant very quickly if the situation warrants. What that all means is that we're very flexible, and that is a great asset in this business, particularly during bad economic times."

The company's new headquarters are in Itasca, Ill., though, through a decentralized approach to management, divisions are located in areas of strategic significance. Each division—one for each concept—has a president, and all report to Smith. Senior management is comprised of experienced Chart House executives and others Smith has worked with before at PepsiCo and Burger King.

Though the company's Burger King division, headed by Chart House veteran Bill Hyde, who preceded Smith as CEO, is the predominant source of cash for the company, further expansion of the system will be minimal at about a dozen new units a year. The Chart House division, also led by a Chart House veteran, John Creed, has never been a big growth vehicle. The concept, which is very expensive and time-consuming to build, does not have nearly the return on investment potential as other concepts, at only one dollar of sales to one-dollar of capital investment. It is expected that Smith, following the philosophy of channeling money into high growth, high return concepts at the expense of others, will at some point sell off the division, though Creed is making changes to improve returns. And, though the company is excited about its new Moxie's gourmet hamburger concept (now being used as the conversion vehicle for discontinued Cork N' Cleaver and Cisco's concepts), it is still too early to tell what contribution Moxie's will make to the company in the long term. Moxie's president, Shawn Holder, worked with Creed in Chart House's steak house division, and was named to his new post by Smith.

Of Diversifoods' five concepts, Godfather's and Luther's are key, they have the greatest potential for growth. As a result of the merger, Godfather's replaced Luther's as top expansion vehicle. By 1990, the pizza chain's current base of 900 restaurants could well reach 2,000, according to Smith. Between company and franchised growth, 180 to 200 Godfather's units are planned to be added each year.

But new openings aren't the only means of reaching those goals. When asked whether Diversifoods is scouting out potential acquisition targets in the pizza segment, Thiesen replies, "I will not deny that we are looking to acquire regional pizza chains, or that we may be negotiating with some. This isn't all the activity you'll see from us. We're not finished yet."

Godfather's will also concentrate on entering major metro areas, where Pizza Hut does not have a presence. In New York, for instance, the Riese Organization will build 75 units.

900-unit Godfather's is courting smaller pizza chains.

Fledgling Luther's hopes to lead the barbecue segment.

Pan pizza, which was rolled out in July, is a major step toward boosting sales and customer counts. Though the introduction is a late one, the company is confident of a complete turnaround. Company Godfather's units peaked in sales in 1981 at $556,000 annually, but declined to $510,000 last year. Franchised stores also peaked in '81, reaching $443,000, though their average last year was $400,000.

"During our initial testing, most restaurants with the pan pizza were running a minimum of 12 to 15 percent sales increases," says Boppell. "Our product is superior. It travels better because of an extra layer of cheese next to the crust, which prevents sauce from soaking in. That's a real advantage since 40 percent of the pizza business is carryout." Boppell also notes that home delivery will be introduced next year.

The reappearance of a less typecast "Godfather" character in advertising is being counted on to help boost sales as well. Also, a comparative advertising campaign is being introduced soon which will stress Godfather's product superiority.

Luther's, though taking a back seat to Godfather's, is Diversifoods' other high growth potential concept. Under Jeff Jefferson, who also worked with Smith at Pizza Hut and is now president of the Luther's division, the proprietary barbecue chain will undergo many changes and rapid expansion. Scheduled to grow to 135 units this year, and to nearly 250 in 1985, the concept is being improved for greater efficiency and profit. A modified building prototype is 1,000 square feet smaller than the original 6,000 square foot Luther's building; the dining room has been subdivided rather than open space-designed; and drive-thru windows have been improved to boost takeout sales. To reduce cooking time and food cost, convection-supplemented barbecue pits are replacing original pits, cutting cooking time from 16 to eight hours.

Luther's a fast service barbecue concept acquired by Chart House in 1981 from Chandler, who later sold Spoons to Saga, features barbecue brisket, pork ribs, chicken, and hamburgers. Its primary market, according to Jefferson, consists of 25-45 year-old males. Under the revamp, regional menu items are being considered, as are items that will appeal more to women and children. These items include individual salads and a children's menu, a chili, burritos, and tacos. Luther's $4 average check places it in a unique position: It is virtually unchallenged by similar competitors, earning Luther's designation as the possible "McDonald's of the barbecue business," by Michael Culp, industry analyst with Prudential-Bache Securities.

"There are no major chain competitors in the barbecue segment, and Luther's should do well against the mom and pops," says Culp. "We've long viewed the concept as an attractive growth vehicle for the company. Quality is high, portions large, and presentation is good."

The new Diversifoods will depend heavily on its pizza and barbecue concepts, but with its unique group of professional managers it seems unlikely that diversification is complete. Smith says he is considering, "either by acquisition or internal development," adding more concepts to the portfolio. Pasta is a possibility, but so might be chicken, seafood, or some other concept.

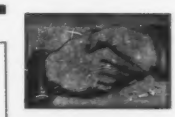
According to Culp, that sort of move is likely to occur after "the Godfather's/Chart House merger has been fully digested." Diversifoods now has a $100 million line of credit, twice that of Chart House. The company's balance sheet shows 33 percent debt to total capital. "That's one of the strongest in the industry," points out Culp, stressing that further diversification would not be a problem for the company.

With Thiesen, Trotter, Smith, Boppell, Jefferson, and the others, the new Diversifoods promises to be among the more interesting restaurant companies to watch over the next few years. A lot has taken place since Aspen. **—Ralph Raffio**

Chairman Trotter is trying to build strength with seasoned managers.

Godfather's Thiesen is looking for improved sales and growth.

CEO Smith will stick with high growth, high return concepts.



VICORP

Buying spree builds opportunity

Skillful management has long made Denver-based Vicorp Restaurants, parent of Village Inn Pancake House Restaurants, one of the industry's more reliable performers. In the early 1980s, when other operators in the mature coffee shop segment lost out to the recession and to trendier concepts, Vicorp's sales maintained a steady if unspectacular upward beat.

Recently, however, this conservative firm has surprised industry watchers with a bold buying spree. In little over a year, Vicorp has spent approximately $168 million acquiring restaurant chains, adding 295 units to its 180-unit core.

Vicorp claims that there is no stated strategy behind the buying. Rather, the company says it has acted opportunistically, moving quickly to buy as deals presented themselves.

"When that right combination comes along, you have to be ready to act," said Vicorp secretary/treasurer Peter Doane, in an interview this April. "I can tell you that right at the moment, we aren't contemplating any acquisitions, but we weren't before either." The following June, Vicorp announced two more acquisitions, one of major proportions.

Growth of this nature can't help but attract attention, especially since Vicorp has insisted on putting some large bundles into its shopping bag. Critics point out that the company is now mortgaged to the hilt, toting almost a 3-to-1 debt-to-equity ratio as of June. This ratio will fall to approximately 1.6-to-1 after the closing of Vicorp's most recent acquisition due to the concurrent issuing of $47.5 million of new preferred stock. Others, however, take heart from Vicorp's two major strengths: able management and a good cash flow. "The style is extremely opportunistic, with two plus two equaling five," says one Wall Street admirer. "If I didn't have the faith in management that I do, I would be scared."

The acquisitions that have made Vicorp grow so quickly are:

- In May, 1983, Vicorp purchased Pillsbury Corp.'s 59-unit Poppin Fresh restaurant chain for $38 million.
- In February, 1984, Vicorp purchased the 72-unit Continental Restaurant Systems (CRS) from Ralston Purina for $61 million.
- In June, 1984 Vicorp signed a letter of intent to purchase 183 Seasons Restaurants from Sambo's Restaurants, Inc. These units will cost Vicorp another $62.5 million.

There have been smaller purchases too. In July, 1982 Vicorp bought nine specialty restaurants from CRS and in October, 1983 picked up 16 Sambo's. Also, in June of this year, Vicorp purchased The Perfect Pan, Inc, a six-unit dinner house chain based in San Diego.

The impact of these purchases has been both immediate and dramatic. Vicorp's sales jumped 113 percent to $86 million in 1983 as a result of the Poppin Fresh purchase; 1984 sales are expected to soar another 200 to 300 percent. (The company's 1984 sales, not including the recent Seasons acquisition, have been projected at near $300 million.) 1983 earnings per share rose $.85, an increase of 49 percent over 1982 (adjusted to reflect a two-for-one split in 1983).

On the other hand, Vicorp now bears a debt of over $100 million and must now maneuver through uncharted waters as it assimilates the varied restaurants it bought. The buying has also altered Vicorp's mix of corporate and franchised units. Originally a highly franchised company, Vicorp has found that the process of converting newly-purchased restaurants into other concepts favors corporate growth. "We remain committed to franchise expansion," says Doane. Generally, the company prefers to reserve only core markets for company growth.

Industry sources attribute Vicorp's new opportunism to the leadership team of Gordon Miles and Charles Frederickson respectively chairman of the board and president of Vicorp. Founded in 1958 by two Denver entrepreneurs, the company was in its early years run like a family business. In 1977, the company was bought by a group of investors, led by Miles and Frederickson.

During the first five years of Miles and Frederickson's involvement, Vicorp remained a low profile firm, concentrating its energies in expanding its Village Inn chain in known middle American markets.

Historically, Village Inn's growth has been through construction of new free-standing buildings. In the early 80s Miles and Frederickson began to wonder if they had missed the boat by ignoring conversions.

This led to Vicorp's acquisition of nine dinner house units from CRS. These were used to launch two specialty restaurant concepts: Varieties, a nightclub and restaurant, and The Rose, an Irish pub concept.

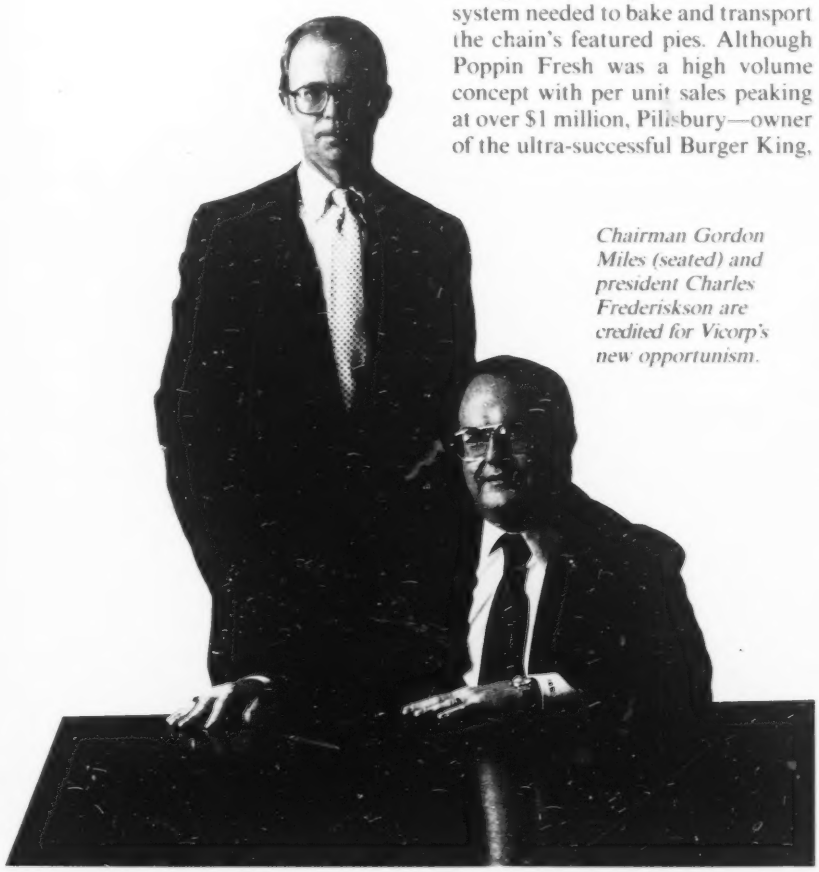
It was Vicorp's second acquisi-

tion, however, that made the industry take notice. This was the Poppin Fresh deal, initiated after Miles received a letter in the mail announcing the availablity of certain Poppin Fresh units. Initially unenthusiastic, his interest grew when he learned that Pillsbury might be interested in selling the entire chain at book value. Moreover, Pillsbury was willing to transfer over $21 million of Poppin Fresh's long-term debt at interest rates ranging from nine to 13 percent. This left approximately $17 million of the $38 million asking price to be paid upfront.

Once the decision was made to buy, Vicorp moved quickly to raise the cash. After securing a bridge loan from Merrill-Lynch, the company raised $21 million by issuing 880,000 shares of common stock in a second public offering (Vicorp went public in August, 1982).

Miles wanted Poppin Fresh for a variety of reasons: First, Poppin Fresh's bakery format was a natural complement to the Village Inn chain. Miles envisioned the sale of Poppin Fresh Pies in the Village Inn units, and the addition of breakfast to the Poppin Fresh restaurants. Moreover, Poppin Fresh had achieved significant penetration in the Chicago and Minneapolis areas—two markets where Village Inn had zero presence. And finally, Miles liked the concept and felt that there was nothing fundamentally wrong with the chain.

Yet, Poppin Fresh did not come without some built-in problems. Primary among these was the profit-eating commissary and distribution system needed to bake and transport the chain's featured pies. Although Poppin Fresh was a high volume concept with per unit sales peaking at over $1 million, Pillsbury—owner of the ultra-successful Burger King, Bennigan's and Steak and Ale chains—had always considered its profit contributions disappointing. And at the time of the transaction with Vicorp, per unit sales had dropped off to under $900,000.



Chairman Gordon Miles (seated) and president Charles Frederiskson are credited for Vicorp's new opportunism.

Miles is betting that he can offset the commissary and distribution drain by increasing the number of outlets they service. To this end, Vicorp is expanding the Poppin Fresh concept, now renamed Baker Square, in both a full-service and mall-oriented retail format. Wholesale distribution of pies to other restaurant chains, including the Village Inn chain, is also underway.

In February, 1984, while still assimilating the Poppin Fresh units, Vicorp was approached by the head of Ralston Purina's Continental Restaurants Systems. The two had established a working rapport during Vicorp's earlier acquisition of the nine CRS dinner house units. Now, the division was on the block.

Again, Vicorp jumped. This specialty dinner house chain—most likely sold to create cash for future acquisitions by Ralston Purina—is another sound operation. Moreover, CRS provided Vicorp with an opportunity to move more seriously into the dinner house segment. CRS offered a mismatched string of profitable specialty restaurant concepts, including the high volume, 14-unit Carlos Murphy's chain. It also brought with it a skilled management team that was used to working autonomously. This dinner house expertise was a boon for Vicorp.

To raise the $61 million needed to buy CRS, Vicorp went back to Merril-Lynch to arrange mid-term financing.

"We felt that CRS offered sufficient cash flow to carry a mid-term debt, and that the market for our stock was not where we wanted it to obtain additional equity capital," Doane says. The sale of $50 million worth of 13.5 yield convertible "baby bonds" provided the solution.

New and little used, baby bonds differ from conventional bonds in

the small denomination in which they are offered. Instead of the usual $1,000 minimum, baby bonds are available at $25, providing access for small investors. Doane expects Vicorp's per share value, ranging around the $18 mark as of June, to reach the $25.20 conversion price within 2-3 years.

Planned for the CRS division is continued expansion in previously penetrated areas (primarily California and the Great Lakes states). The six-unit Perfect Pan chain, acquired in June, will be assimilated into this division. Also taken under the CRS wing are Varieties and The Rose, both now undergoing conversion into other CRS concepts.

Barely had Vicorp completed the sale of its baby bonds when the company signed a letter of intent to buy 183 Seasons Restaurants from bankrupt Sambo's. This occurred after a planned merger of assets between Sambo's and Consolidated Products, Inc. (formerly Steak 'n Shake, Inc.) fell through. To acquire the Seasons units, Vicorp will pay Sambo's creditors $6 million in cash, $47.5 million in convertible preferred stock, and $9 million in secured and unsecured notes.

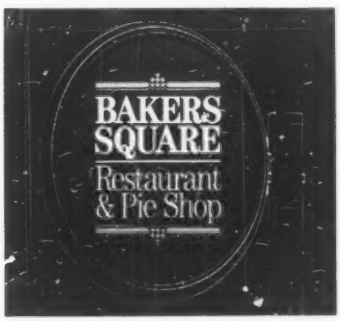
Vicorp will use the new units to expand the Bakers Square and Village Inn chains. The 183 units, concentrated in Sambo's core California and Florida markets, provide some excellent locations, says Miles. "At one time, Sambo's had 1,000 units, then they reduced these to the best 220," he explains. "On this basis we bought 183 of them."

Although the company eschews formal acquisition planning, a certain pattern has emerged regarding Vicorp's growth. Don't expect Vicorp to leap from the mature segments where it is comfortable into the glamour foods, such as fast foods or gourmet burgers. It won't, says Miles. The reason? Tighter competition.

Vicorp is also unlikely to go out and start up its own new concepts, says Miles. After the experiences with The Rose and Varieties, "we learned that this type of innovation isn't our strong suit," he admits.

For now, purchasing will slow down, Miles adds. There are units to convert, restaurants to manage, debts to pay. Yet, one suspects that the door remains open. "We continue to look at opportunities," says Vicorp's Doane, "and we seem to see more of them all the time."

—Alexa Bell



A new name and image have helped Vicorp increase Poppin Fresh's sagging sales.

Carlos Murphy's, one of many dinner house concepts acquired from Ralston Purina, is now a major growth vehicle.

R.J. REYNOLDS

A smooth flavor for foodservice

R.J. Reynolds Industries, Inc, (RJR), is a $13.5 billion company, perhaps best known as a worldwide leader in the tobacco segment. But the Winston-Salem, N.C., company also happens to own the largest fast food chicken chain in the world (Kentucky Fried Chicken), the fifth largest institutional feeder in the country (Service Systems Corp.), a fledgling quick service bagel restaurant group called Skolniks, and rights to one of the nation's new healthy fast food concepts (The Fresher Cooker).

Foodservice revenues (including franchise fees but excluding sales of franchises) are in the range of 10 percent of the company's total.

Therein lies but one aspect of RJR's multi-faceted long-term diversification strategy: entrench solidly in the growing consumer services industry through foodservice.

Make no mistake: with more than half of its net sales generated by tobacco, the company will continue to be very consumer-product oriented. Yet Reynolds has lately made several astute buys which simultaneously strengthened its presence in both products and services—Del Monte, which included Service Systems; and Heublein, parent of KFC.

Evincing further commitment to this two-pronged marketing orientation, RJR is jettisoning its non-consumer businesses. The company is in the process of spinning off its Sea-Land containerized shipping segment, and has formed a study group to examine the future of Aminoil, the tobacco giant's domestic energy company. Observers believe that, ultimately, Aminoil will be either spun off to shareholders or sold outright.

Such diversification, in addition to augmenting sales and earnings, makes the company more recession-proof. RJR's portfolio makes the company less liable to downturns in overall results. Moreover, all of its businesses are global in nature—more than one-third of its sales are generated abroad—making the parent less likely to suffer the effects of regional recession.

For example, domestic tobacco sales took a beating in 1983, when the federal excise tax on cigarettes was doubled and 14 states increased their cigarette taxes. As a result, domestic consumer volume declined about six percent.

Richard Mayer moved to KFC when Reynolds acquired former parent Heublein in 1982.

That decline, however, was offset partially by volume increases in the international side of RJR's tobacco business. And while earnings from operations dropped 2.8 percent, overall corporate income was up 5.6 percent, thanks in part to dramatic improvements in the Foods & Beverages segment, which comprises the Heublein, KFC, and Del Monte subsidiaries. (Service Systems, Skolniks, and the entity holding the rights to Fresher Cooker operate under the umbrella of another Reynolds subsidiary called R.J. Reynolds Development Corp.)

Reynolds' strategy involves plowing part of the tremendous amount of cash generated by tobacco into the company's heavy-growth Foods & Beverages businesses. Over the next three years, in fact, RJR plans to pour nearly $1 billion in capital expenditures into Del Monte, Heublein, and Kentucky Fried Chicken.

These new businesses will benefit from their parent's strengths in marketing and positioning product, particularly under newly named Reynolds chairman and chief executive officer J. Tylee Wilson, whose professional past includes a stint at mega-marketer Procter & Gamble. RJR's long and successful history of differentiating literally dozens of brands of cigarettes from each other and from the competition will be brought to bear on all its businesses.

Much of that work has already been accomplished at Del Monte,

acquired in February, 1979, for about $618 million. The acquisition established the tobacco giant for the first time in canned and frozen foods, specialty groceries, fresh fruits, and—through a "back door" approach—foodservice.

Restructuring and repositioning of the new organization began almost immediately. Service Systems was split from its former parent, which became the basis of the new Foods & Beverages group. Del Monte underwent a transformation from a production-oriented to a consumer-driven business, one which RJR believes is capable of higher returns on assets. Overhead was reduced, and fresh fruit and grocery operations were strengthened. 1982 and 1983 saw the introduction of several timely new products, including reduced-calorie canned fruits and no-salt-added canned vegetables. A line of upscale frozen dinners and entrees is also being introduced; all the introductions have been accompanied by the same type of savvy marketing and advertising that Reynolds used to reserve for its smokes.

Service Systems became a cornerstone of R.J. Reynolds Development Corp., a new RJR subsidiary formed in January, 1981, to function as the entrepreneurial arm of the parent. Charged with supervision of those growth-potential companies that nonetheless do not fit RJR's existing lines of business (like Service Systems), Development Corp. was also created to discover and manage new business opportunities for Reynolds.

It was through Development Corp. that Skolniks Bagel Bakery Restaurants was acquired and that an agreement was signed with Fresher Cooker. And indeed, the development arm is planned as an avenue for future diversification. According to Robert Van Camp, president and chief executive officer of Development Corp., the new subsidiary creates the "growth environment" for emerging companies which could, over time, become significant to Reynolds, or for medium-size companies without a well-defined strategic plan. Development Corp., says Van Camp., helps these companies develop strategic growth plans and execute them.

Service Systems has tripled in size in its three years under Development Corp., moving from its low-focus position at Del Monte to one of rank in its field at Reynolds. Much of this growth has come through acquisitions of its own. In January, 1982, Service Systems expanded its market in the mid-Atlantic, Northeast and Midwest with the acquisition of Stouffer Management Food Services, and a year later the company acquired Mannings Inc. in San Francisco, strengthening its presence in the Northwest and California.

The 30-year-old Service Systems, which operates autonomously from its headquarters in Buffalo, New York, has a diversified base of about 1,600 accounts in 35 states. Its clients include those in education, business and industry, health and life care, and recreation.

While Service Systems was an added "dividend" in Reynolds' acquisition of Del Monte, the presence of Kentucky Fried Chicken was a powerful incentive in the purchase of Heublein, completed in August, 1982, at a total cost of $1.36 billion.

Says Van Camp: "In late 1981, Reynolds had targeted the public foodservice sector as an area to enter. The company was very committed to in-home food products through Del Monte, and to a lesser extent, to away-from-home business through Service Systems. Packaged, frozen, refrigerated, and fresh food was represented by Del Monte, and institutional foodservice was represented by Service Systems—the company was complete except for this public sector gap."

So, in addition to its entry into the lucrative $55 billion beverage alcohol market with Heublein, Reynolds got KFC, the leader in the fast food chicken segment with more than 5,700 units worldwide.

Reynolds' capital will enable KFC to expand to nearly 8,000 units by 1988.

Reynolds' plans for the expansion of KFC are ambitious. In 1984, company and franchised stores both domestically and abroad will open at the rate of one every 21 hours. The international market will be exploited as never before, with about 176 of the total of 416 planned openings this year to occur outside the U.S. Reynolds' total capital commitment to KFC for 1984 is more than $168 million. In return, KFC generates

tidy sales; in 1983, the chicken chain's sales increased by 18 percent to $2.6 billion, seven percentage points higher than the overall sales of the quick service restaurant segment in the U.S. KFC's real growth (sales gains after adjustments for menu price increases) has been running at five percent for five consecutive years, compared with an estimated industry average of two to three percent.

Over the next five years, about 2,200 new KFC's will open, divided almost equally between domestic and international markets; by 1988, the company expects to have nearly 7,800 units in operation around the world.

Expansion like this is one of the more obvious benefits of being acquired by a cash-rich giant like Reynolds, say KFC executives. According to chairman and chief executive officer Richard P. Mayer, who moved to KFC from Heublein following the acquisition, the combination was a particularly fortuitous one for KFC. Having recovered handily from a slump in the mid-70s by returning to fundamental quality standards in product and service, the chicken chain has been anxious to flex its muscles again.

KFC was headed into a healthy growth phase anyway, says Mayer, but Heublein could never have offered the capital expenditures of its new parent. "One reason Reynolds was attracted to Heublein was KFC," says Mayer. "Our profits actually exceed theirs, percentage-wise. Foodservice was a new industry for them and they could acquire the leader in the chicken segment. They have the capital to expand at a much faster rate than Heublein could have handled. In return, we are a tremendous growth vehicle for Reynolds."

Mayer terms the acquisition a "marriage made in heaven" for other reasons as well. With headquarters in Louisville, Ky., KFC was used to operating with considerable autonomy under Connecticut-based Heublein. Under Reynolds, KFC has even more independence.

Compared to the mighty and far-flung KFC, Skolniks is but a drop of water in Reynolds' ocean. But the 10-unit quick-service bagel restaurant is still very much a factor in the corporation's strategy.

Skolniks was acquired as a two-unit Philadelphia-based chain in March, 1982, and through late 1982 and 1983, the concept was expanded to 10 units and fine-tuned. Current markets include Philadelphia, Chicago, Dallas, Cincinnati, Washington, D.C., and Cherry Hill, N.J.

Development Corp.'s "buy small and build big" strategy is being implemented with Skolniks, which was acquired as a way to develop expertise in the specialty foodservice business. The Skolniks acquisition—which occurred before the Heublein/KFC transaction—represented Reynolds' first foray into the public sector of foodservice.

The Skolniks concept is a simple one. All units are bagel bakeries, located in upscale malls, with both sit-down and take-out service. The decor is similar to that of a French bakery, with white-and-blue tile, plants and brass accents. The all-day menu features hot and cold sandwiches on 10 types of bagels, salads, soups, and omelets. One unit has a wine and beer license.

Skolniks is still considered a development stage company, as well as another opportunity for Reynolds to grow in foodservice. Up to 20 additional Skolniks will be built in 1984 in various markets; future expansion has yet to be determined.

Fresher Cooker is yet another restaurant opportunity for Reynolds. This spring, Development Corp. signed a franchise agreement with the Louisville-based company to open several Fresher Cooker healthy quick service restaurants in 1984. The agreement also grants Development Corp. the option to open about 225 Fresher Cookers in Florida and three other markets over the next 10 years. The Fresher Cooker concept features freshly prepared, homemade foods such as sandwiches, pastas, salads, soups, and baked potatoes served in a fast food format.

Reynolds will continue to find new opportunities in add-on acquisitions (such as Del Monte's recent purchase of Canada Dry) and through the activities of Development Corp. Additional major acquisitions, such as those of Heublein and Del Monte which positioned Reynolds solidly in the food, beverage and foodservice industries, are less likely in the short-term.

—Joan Lang

Robert Van Camp heads an RJR arm which acquires new concepts like Skolniks.

Following the leaders

Below is a select group of movers and shakers maneuvering for growth via mergers and/or acquisitions. The chart traces activity from February 1979 through June 1984 and was compiled by *Restaurant Business* and The Food Institute.

Parent/subsidiary	Date of acquisition	Value of transaction (in millions)	Fiscal '83 revenues (in millions)	Comment
ALLEGHENY BEVERAGE CORPORATION Food Service Management Inc.	1/84	undisclosed	$526.1 undisclosed	An ABC foodservice subsidiary, The Macke Company, bought Food Service Management, a commercial contract caterer based in St. Louis, as a geographical complement to its earlier acquisition of Ed-American Food-service Inc., Kansas City, KS.
ARTHUR TREACHER'S INC. Arthur Treacher's Fish & Chips	2/84	$ 2.0	7.5	Through a series of transactions with various non-operating entities, the one-time seafood segment leader emerged from bankruptcy as Arthur Treacher's Inc., a publicly held Utah corporation with headquarters in Ohio. The company now expects to open new units for the first time in years in the Cleveland and D.C. areas.
BAY BOTTLERS INC. Magic Pan International Inc.	6/82	10.0	110.0 70.0	Magic Pan was a good fit for this Oakland-based bottling company looking for a sturdy, non-franchised concept through which to enter the restaurant business. Bay Bottlers is looking for more chains to buy, in order to grow to 250-300 units (from a current base of 78) by 1990.
BRIGHAM'S INC. Brigham's	4/82	undisclosed	30.0	Jewel Companies sold Brigham's as part of ongoing consolidation to former Brigham's president Richard Johnson (then president of Hickory Farms). Johnson now claims a 25 percent sales increase with no new units, partially due to current ice cream boom.
CHURCH'S FRIED CHICKEN INC. Ron's Krispy Fried Chicken Inc.	9/83	7.5	464.1 20.0*	Comparatively upscale Ron's provided Church's with quick penetration of eastern Texas market (lost when KFC purchased Church's Houston franchisee) and a way to test a higher priced menu format. Existing Church's in area have been converted into Ron's.
COLLINS FOODS INT'L. INC. Gino's East	11/83	2.5	325.4 4.2	Established Chicago pizzeria gives company a product and name to develop its own concept on. Australia will be developed to compete with Pizza Hut. First U.S. openings have been in Cal., where company is based.
DENNY'S INC. El Pollo Loco	10/83	11.3	1,054.6 15.2*	Acquisition secured worldwide rights, excluding Mexico, to the Mexican-style charbroiled chicken concept, along with all 19 U.S. locations. Additionally, since 1982 company has purchased over 200 locations from competitors for Denny's conversions.
DIVERSIFOODS INC. Chart House Inc. Godfather's Pizza Inc.	12/83 12/83	308.0	484.0 367.0 117.0	Merger of Chart House and Godfather's resulted in formation of new company, Diversifoods. Company operates five different concepts currently, primarily beef-related, and is considering further concept development or purchases. Main concentration now is developing Godfather's and Luther's Bar-B-Que concepts. Luther's was acquired by Chart House in 1981.

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GARCIA'S OF SCOTSDALE INC. Famous Restaurants Inc.	2/84	7.2	36.0 7.0	Capital-short Famous was considering a public offering to fuel expansion when Garcia's acquired it. Garcia's on its part sought entry into burgeoning grilled fish market. Since acquisition, Famous's Pacific Fish Company concept has doubled to 6 units; more construction is underway.
THE HORN & HARDART COMPANY Bojangles of America Inc.	12/81	10.4	339.0 68.0	Essentially a franchisee and mail order company, H&H wanted its own concept to franchise. Bojangles consisted of under 50 units at acquisition, was up to 220 in '83 and 200 openings are planned this year. Future H&H growth will be through acquisition of foodservice and mail order companies.
HUNGRY TIGER Lobster House Inc.	3/83	5.0	63.8 15.2	Four years after acquisition of quick-service Breakers concept, HT purchased multi-concept Lobster House's 13 restaurants to continue pattern of growth through acquisition. Since acquisition, HT sold two units, converted three to Breakers, and began one new concept construction.
INT'L. DAIRY QUEEN INC. Golden Skillet Int'l. Inc.	12/81	undisclosed	117.0 1.8*	IDQ sought diversification through acquisition of chains which are, like itself, franchised only, and which have substantial geographic representaton.
KELLY-JOHNSTON ENTERPRISES Duff's Enterprises Inc.	8/83	18.0	40.9 51.5	Company, built as largest Chi-Chi's franchisee, chose diversification. Duff's move positioned company as franchisor for first time. K-J acquired single-unit Joe Kelly's dinner house the same year, and is franchising.
K MART CORPORATION Furrs Cafeterias Bishop Buffets Inc.	5/80 12/83	70.0 29.0	*18,878.9* *undisclosed* *18.6*	K Mart's move into cafeterias allows it to use its own similar management systems as well as to grow into new markets. An attempt to acquire Associated Hosts (hotels and theme restaurants) failed earlier this year, but K Mart is still looking.
KRYSTAL CORPORATION Po Folks Inc.	10/82	4.2	undisclosed 13.5	This regional chain had been unsuccessful in its goal of bringing its own hamburger concept national. Acquisition of Po Folks, a down-home Southern concept, gave it the vehicle for nationwide development. Company owned 12 units and licensed 70 at '83-end.
MARRIOTT CORPORATION Gino's Inc. Host International Inc.	2/82 3/82	48.0 148.8	3,000.0 NA undisclosed	Gino's units were converted to Roy Rogers, substantially boosting RR's presence in northeast. Host acquisition boosted airport foodservice business, and added four hotels, 49 specialty restaurants, and 77 gift shops to Marriott.
MORRISON INC. Ruby Tuesday L&N Fishmarket	4/82 4/82	15.0 undisclosed	422.0 29.0* 3.0*	Determined to diversify, Morrison purchased two concepts with lower start-up costs and higher returns on investment than its cafeterias. To avoid saturation in its cafeteria segment, bulk of company's expansion will be through these and possible other acquisitions.
OGDEN CORPORATION Air La Carte	5/84	undisclosed	2,000.0 40.0	Integrated with Ogden's $60 million/year Travel Services division, Air La Carte added additional business in a six-city growth area and in South American and Pacific markets.
PEOPLE'S RESTAURANTS INC. Pané Vino	4/83	1.5	27.3 0.175	Acquisition of this single upscale Italian dinner house gave company growth-potential concept which could also be developed in same malls as its Michael's retail stores and People's restaurants.
THE PILLSBURY COMPANY Haagen-Dazs Ice Cream	7/83	75.0	3,700.0 76.0	Purchase of ice cream retail product/dipping store chain fit company's strategy of acquiring at least six small companies per year. Ice cream segment growing, and Pillsbury sees further potential. In June '84, Pillsbury agreed to purchase N.Y.-based Sedutto Ice Cream Corp.

**Estimated by* Restaurant Business

continued on page 173

Parent/subsidiary	Date of acquisition	Value of transaction (in millions)	Fiscal '83 revenues (in millions)	Comment
PONDEROSA INC.			385.1	Mexican concept appeals to different clientele, and is not as susceptible to beef prices as steak houses. Concept can also be licensed to current Ponderosa franchisees. At acquisition, concept was viewed as a conversion vehicle for underperforming steakhouses, but success of new salad bar has made conversion unnecessary.
Casa Lupita	4/82	undisclosed	0.838	
RAINS INTERNATIONAL INC.			—	Some complications: In 1982, franchisee Harley Hotels, recently purchased by Harry Helmsley, bought out parent Dutch Pantry. By Dec. '83 Harley wanted out. Sold DP and institutional food line Kemberling Foods to new company Rains Int'l., formed specifically to make acquisition.
Dutch Pantry Inc.	12/83	undisclosed	30.0	
RESTAURANT ASSOCIATES INDUSTRIES INC.			141.1	RA acquired 40 percent interest in Acapulco y Los Arcos after collapse of possible joint venture involving introduction of L.A.-based Tex-Mex chain in the East. Desiring a West Coast equity position, RA bought out founder Ray Marshall among others. For now, growth will retain western focus.
Acapulco Restaurants	12/83	9.0	37.9	
R.J. REYNOLDS INDUSTRIES INC.			13,533.0	Acquisitions strengthened company in consumer products and services sectors. With Del Monte, Reynolds entered food business and got contract feeder Service Systems as added bonus. Heublein acquisition placed Reynolds in beverage alcohol business and also included 6,600-unit Kentucky Fried Chicken chain.
Del Monte Corp.	2/79	618.0	undisclosed	
Skolniks Bagel Bakery	3/82	undisclosed	undisclosed	
Heublein Inc.	8/82	1,360.0	undisclosed	
SAGA CORPORATION			979.0	Acquisition of upscale chicken chain gave company expansion vehicle able to function with autonomy and little modification. Spoons move followed failed attempt to acquire Chili's, and marked company's entry into upscale burger segment.
Grandy's Inc.	7/83	66.0	27.0	
Spoons Restaurants Inc.	8/83	3.0	5.0	
SHAKEY'S INC.			—	Unhappy franchisees encouraged former owner Hunt Int'l. to sell. When prospective deal fell through, franchisees Gary Brown and Jay Halverson purchased 54 percent of company through leveraged buy out, with USA Cafes acquiring another 36 percent. Currently planned: divestment of company-owned units.
Shakey's Inc. (division of Hunt Int'l)	1/84	17.0	20.2	
SHONEY'S INC.			397.8	Acquisition dissolved Shoney's relationship with Kentucky Fried Chicken as a 22-unit franchisee, and opened way for company to develop national chicken chain of its own. In '83 company licensed 215 stores and owned 15. This year Shoney's split with Marriott Corp. as Big Boy system's largest franchisee.
Famous Recipe Fried Chicken Inc.	10/81	2.2	7.2*	
TENLY ENTERPRISES INC.			60.0	Private investors purchased 110-unit steakhouse chain and one theme restaurant from ready-to-sell Marriott Corp. Tenley immediately disposed of 35 Rustlers in West and is concentrating on eastern penetration. Moderate expansion of steakhouse planned.
Rustler Steakhouses	5/83	undisclosed		
VICORP RESTAURANTS INC.			95.6	Poppin' Fresh (now Baker's Square) move complemented company's Village Inn breakfast concept. Disappointed with own test dinner house concepts, Vicorp acquired successful CRS chain for expansion: soon added Perfect Pan to this division. In June '84 bought 183 Seasons Restaurants from Sambo's for 62.5 million. Will convert into Baker's Squares.
Poppin' Fresh Pies Inc.	5/83	38.0	61.0	
Continental Restaurant Systems	2/84	60.0	133.0	
The Perfect Pan Inc.	6/84	3.4	7.0	
W.R. GRACE & COMPANY			6,200.0	Fast food division zeroed in on "adult fast food" market. Applebee's fills middle ground between fast food and full service. Bought 2 units, now up to 6. Since purchasing profitable Gladstone's 4 Fish and R.J.'s—The Rib Place, Grace has been converting substandard units from its dinner house chains into these concepts.
T.J. Applebee's	4/83	undisclosed	2.8*	
Mor Food 'n Fun	5/83	undisclosed	14.0*	

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